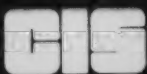


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INCREASING IMF-WORLD BANK COOPERATION

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL
DEVELOPMENT INSTITUTIONS AND FINANCE

AND THE

SUBCOMMITTEE ON INTERNATIONAL
FINANCE, TRADE AND MONETARY POLICY

OF THE

COMMITTEE ON
BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

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INCREASING IMF-WORLD BANK COOPERATION

THURSDAY, JULY 25, 1985

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON INTERNATIONAL FINANCE, TRADE AND MONETARY POLICY, AND SUBCOMMITTEE ON INTERNATIONAL DEVELOPMENT INSTITUTIONS AND FINANCE, COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,

Washington, DC.

The joint subcommittees met, pursuant to call, at 9:30 a.m., in room 2128, Rayburn House Office Building, Hon. Stan Lundine (chairman of the Subcommittee on International Development Institutions and Finance) and Hon. Stephen L. Neal (chairman of the Subcommittee on International Finance, Trade and Monetary Policy) presiding.

Present: Representatives Lundine, Neal, Bereuter, Leach, and Parris.

Chairman LUNDINE. The committee will come to order.

This morning's hearing is a joint hearing between the International Development Subcommittee and the International Finance Subcommittee of the House Banking Committee. The International Finance Committee, chaired by my colleague from North Carolina, Mr. Neal, has jurisdiction over the International Monetary Fund, and the International Development Subcommittee, which I chair, has jurisdiction over the World Bank and the other multilateral development banks.

We will focus today on the issue of increasing cooperation between the IMF and the World Bank. I welcome all of my colleagues from the International Finance, Trade and Monetary Policy Subcommittee, including, of course, Mr. Neal, who is cochairing this joint hearing of our two subcommittees.

I think it is appropriate that as we discuss how these two major international financial institutions can improve their cooperation, those of us on this committee who share jurisdiction over the World Bank and IMF respectfully are likewise cooperating toward that end. Cooperation between the World Bank and the IMF has really been a practical reality for some time now.

Today we will examine what this cooperation has so far entailed and, if desirable, how it can be further encouraged and in what forms. The IMF has historically been an institution active in temporary, short-term balance of payments assistance. The World Bank has principally been oriented for long-term development project lending.

However, as countries attempt to sustain adjustments made in conjunction with the IMF austerity program, the distinction be-

tween structural economic reforms, which address short-term payments imbalance, and long-term development strategies sometimes become blurred.

The key question before us today is how can the IMF and the World Bank work together to meld the short-term and long-term approaches to severe debt and growth problems now confronting the developing nations of the world? It is vital to the future of these countries that the strategies applied in the short and long terms are consistent. Otherwise despite our best intentions, the two institutions' efforts may undercut or even stalemate each other.

This is now the eighth in our series of hearings on the U.S. stake in the favorable resolution of debt and growth problems confronting the developing world. Based on all the testimony we have received to date, it is clear that development and growth must continue in the developing countries if our own economy is also to prosper.

The interdependence of economies of the developed and developing worlds means that economic recovery in the United States and the OECD countries cannot be sustained without recovery in the developing countries. Furthermore, political stability, especially in the new democracies of Latin America and within the continent of Africa, will not remain possible if a healthy growth pattern is not soon reestablished.

In an atmosphere of declining commercial credit availability, the role of the Bank and the Fund takes on ever greater importance. The interrelationship between the IMF and the World Bank is, therefore, a critical ingredient in developing country recovery. It is very much in both the economic and political interests of the United States that these two preeminent international institutions manage to work effectively together. Toward this end, I look forward to hearing from our distinguished panel of witnesses this morning.

Mr. Neal, do you have a statement?

Chairman NEAL. Thank you, Mr. Chairman.

I will just put a statement in the record.

Chairman LUNDINE. Without objection, the opening statement of the gentleman from North Carolina will be put in the record.

[The opening statement of Chairman Neal follows:]

STEPHEN L. NEAL
OPENING STATEMENT
JULY 25, 1985

Welcome to these joint hearings held by the Subcommittee on International Development Institutions and the Subcommittee on International Finance.

The historical connection between our two subcommittees is obvious -- each subcommittee has jurisdiction over an international organization born at Bretton Woods in 1944. This is, however, the first time we have focused together on an issue of mounting concern to both institutions. Clearly, this is because the two international organizations have traditionally played very different roles, without much need for explicit collaboration. That may now be changing. In this joint hearing we want to raise the question whether some blurring in the distinctions drawn between the IMF and the World Bank is now warranted, considering the grave debt problems faced by the LDCs, and, if so, what practical policy conclusions should be drawn.

I am most interested to hear what our witnesses have to say about the possibility of joint IMF - World Bank strategies in assisting deeply indebted developing nations. Do our witnesses think that these institutions can and should flexibly interpret their charters, working together to address the excessive indebtedness of a growing number of the LDCs? Or do our witnesses think that the most effective approach in addressing third world debt problems is to retain the historical distinctions

between the institutions, with the World Bank focusing exclusively on development, and the IMF focusing exclusively on balance-of-payments adjustment? How are these two concepts -- development and adjustment -- to be related in today's world? Are they mutually antagonistic, complementary, or independent of each other? Or do our witnesses agree with Henry Kissinger's statement that "the international financial institutions...have gone to the limit of...what the charter of international organizations will permit," and that consequently, "the United States must now propose the modern philosophical equivalent of the Marshall Plan?" That is, perhaps better IMF/World Bank coordination is, by itself, unequal to the task, so we need yet a third major institution.

I anxiously await the reflections of our experts on these matters. Thank you for appearing before our subcommittees today.

Chairman LUNDINE. Mr. Bereuter, do you have an opening statement?

Mr. BEREUTER. Thank you. I look forward to the hearing. I will forgo a statement this morning.

Chairman LUNDINE. Mr. Leach

Mr. LEACH. I also look forward to the testimony.

Chairman LUNDINE. We have a panel this morning. I will introduce all the witnesses and then ask them to proceed. William Dale served as Deputy Managing Director of the International Monetary Fund for 10 years, from 1974 to 1984. Prior to his service as Deputy Managing Director of the Fund, Mr. Dale served for 11 years as U.S. Executive Director of the IMF. He is presently an international economic consultant.

Colin Bradford, Jr., teaches economics at Yale University, where he also directs the Master's Program in International Relations, and serves as associate director of the Yale Center for International and Area Studies. He served as Director of the Office of Multilateral Development Banks in the U.S. Treasury Department and has participated in several research projects in developing countries in recent years.

Edward Fried is currently the senior fellow with the Brookings Institution in Washington, DC. From 1977 through 1979, Mr. Fried was U.S. Executive Director of the World Bank. Prior to this World Bank assignment, Mr. Fried was Deputy Assistant Secretary of State for Economic Affairs and served in the Johnson administration as International Economic Policy Adviser on the National Security Council.

Mr. E. Dwight Phaup—is that correct?

Mr. PHAUP. Very close.

Chairman LUNDINE. When you got a name like Lundine, you can associate with those problems—is currently professor of economics and chairman of the economics department at Union College in Schenectady, NY. Dr. Phaup has written widely on economic issues with an emphasis on international economics and has several published by the Heritage Foundation and others.

Gentlemen, we welcome you, and we sincerely thank you for taking your time to come here and share your expertise with us. I believe we have written statements from all of you. They will be in their entirety made part of the record. If you are able to summarize your testimony, we would appreciate it.

Mr. Bradford, I think we will begin with you.

STATEMENT OF COLIN I. BRADFORD, JR., PROFESSOR OF INTERNATIONAL ECONOMICS, YALE UNIVERSITY AND FORMER DIRECTOR OF THE OFFICE OF MULTILATERAL DEVELOPMENT BANKS OF THE U.S. DEPARTMENT OF THE TREASURY

Mr. BRADFORD. Thank you very much, Mr. Chairman.

I think I would at least echo many of the concerns that you mentioned in your opening statement, and I would like to begin by saying that despite the fact that I am sure none of us wants to confront a 25-page paper with 38 footnotes at this hour of the morning that since I have been reasonably careful in the argument of the paper, I am going to try to summarize it in somewhat clearer, I

hope, and perhaps in starker form just for the sake of making the issues clear, recognizing that in essence the message that I am really trying to get across is that there is a need for some attention to detail and nuance in some of these issues, especially the one I raise at the end.

Let me also say that however critical one might be about some of the issues that one might raise here that it should be understood that the Bank and the Fund, in my judgment, and I am sure shared by many of the panelists here, are premier economic institutions and fulfill a very major function in the world economy today. They have excellent staffs, the quality of the analytical work is superb and internationally recognized, and there is no question in my mind that these institutions play a very major role and are of great importance to the issues that you highlighted yourself in your opening statement.

Having said that, though, I think there is room for some improvement and correction and action in terms particularly of the U.S. policies that are in the domain of concern of the Fund of the Bank and U.S. policies directly in the Fund of the Bank, themselves.

And what I refer to in the first part of the paper, and which I would highlight first, is the fact that we seem intent in recent years on articulating in world arenas the importance of fiscal balance and market forces at a time when the Fund and the Bank, I think, have played a role recently through both the Interim Committee and the Development Committee in trying to recognize some of the new realities in the world economy, some of the intersections of monetary fiscal trade, exchange rate, and macropolicy elements in the world economy. They convened recently this spring, as you know, a joint meeting of these two important committees of the Bank and the Fund in order to look at several of the trade and growth issues, macropolicies in the world economy jointly, and in their intersection and interaction.

This was a very positive development, I think, but it has to be said that however useful a role the Bank and the Fund have tried to play in this instance, that the real problem is the domestic policies of important industrial countries, and most notably our own, and that there is a certain contradiction to say the least between what we seem to espouse as ideal economic policies and the policies that we actually have, which I think undermines precisely the effort of the Fund and the Bank to play a role in establishing some norms for domestic economic policy behavior at precisely the moment in history when domestic economic policies are the crucial international policies of our time.

So that what has been manifested here, I think, in this very important dimension is not a weakness of the Fund and the Bank and their relations with each other, but is a fundamental weakness in our own domestic economic policies, which are both destabilizing the world economy and undermining the efforts of the Bank and the Fund to achieve some more satisfactory solution at the global level.

The second point I would like to make is to focus on the IMF itself and the relationship you mentioned at the outset between the long-run and short-run responsibilities of these two institutions and

to boil it down to the essence, what I basically arrived at, after having looked fairly careful at recent annual reports, is a feeling that it is not an exaggeration to say that the Fund, despite the availability of other instruments, has become essentially a single window institution, and by that I mean that there is increasingly over time, since the late 1970's, a reduction in the use of longer term instruments that are available to the Fund; and increasingly the 1-year standby arrangements have become the pivot point for the basic lending that the IMF is undertaking.

The three instruments that I have in mind are the Extended Fund Facility, the policy on enlarged access, and the Compensatory Financing Facility. And if one looks at the Extended Fund Facility, for example, one sees that it became important in 1982, when the drawings from the Extended Fund Facility, which allows for multi-year medium-term assistance to overcome structural balance of payment problems, reached about 2.5 billion SDR's and in the 1981-82 financial year of the Fund, which ends April 30, there were 15 countries who had made purchases during that year under EFF facilities. That declined to nine in the financial year 1982-83, and to five in 1983-84, and as of May 30, 1985, there were only three countries that are under Extended Fund Facility arrangements currently.

Now, I must point out that two of those countries are Mexico and Brazil, and it is precisely countries in the kinds of circumstances that have the kind of importance that Mexico and Brazil have where the Extended Fund Facility should be used. But it does seem to me it is clear the amount of resources, the number of countries that are able to make use of them, has declined over the last 4 years.

The second window that is available is a policy on enlarged access which is meant to be available to members for balance-of-payments purposes when these balance-of-payments needs are large in relation to their quotas, larger than the rules would allow, and for longer periods. Essentially what has happened there is two developments in which the percent of the quotas on which countries can draw on the enlarged access window have been reduced by roughly a third, and there is some greater attention by the phrase requirement that drawings can be made depending on the seriousness of the balance of payments needs of the country and strengths of its adjustment efforts.

There is an allusion there to a greater sense of the short-term conditionality that applies to standby arrangements on a shorter term basis. So, again, there is a reduction in the resources available and at least the hint of an increase in the restrictions that might apply to them.

And the same applies in the Compensatory Financing Facility, which is essentially a facility of the Fund that used to be, when it was originally created I think in 1963—William Dale knows better than I—that it was essentially a window meant to provide temporary balance of payments for countries on an automatic basis when there were immediate shortfalls in export earnings, especially having to do with primary products and cereals.

Again, the automaticity that attended to this balance of payments support had to do with the fact that these shortfalls were

largely deemed to be outside the control of the countries concerned. What has happened here also is that the size of the drawings in relation to quotas have been reduced, and the conditionality—there has been a definite tie in this instance of the drawings on the compensatory financing facility with the conditionality on the short-term window. So that I think it is not an exaggeration to say over the period of the last 4 or 5 years, these flexible arrangements, flexible instruments that are available for medium-term financing in the Fund, have been reduced in the amount of resources that can be made available and their conditionality has been tightened.

It is that that leads me to say that the Fund, in essence, I think, has become a one-window operation. This becomes a matter of some concern because of the need that you, yourselves, mentioned at the outset, to mesh the shorter term policy outlook and resources of the Fund with the longer term policy outlook and development assistance resources at the Bank.

That leads to the final topic that I wanted to raise with you, which I think is an interesting one in that we have all been aware over the last 15 years of the rise of importance of the Pacific Basin as an area of economic growth and the resurgence, and it hasn't just been a question of Japan, of course, it has been a question of the rise in that area of the world for major developing countries that seem to have cut loose with exports of manufactured goods which have impressed us to say the least, if not concerned us a bit, as I know you are aware, in terms of the impact on our own economy. I refer here to Hong Kong, Singapore, Taiwan and Korea, the East Asian NIC's, or newly industrialized countries' success stories.

I am afraid that in the thinking about development, in thinking about how to handle economic policy in these troubled times, these Asian success stories have become idealized in the minds of many, and it has flawed, I think, the policy outlooks of both the Bank and the Fund as the success stories have been construed to be of a market driven sort. And what I cite in the testimony at some length are several research studies that have been done, particularly of Singapore, Korea, and Taiwan, which seem to me to clearly show that the reason for the success stories of these countries is not easily stereotyped, that it is both wrong to suggest that East Asian success stories are the result of pure market forces.

And it is also wrong to say, on the other hand, that their success is a result of some sort of successful government intervention alone. I think what distinguishes these three countries and others like them, like Brazil and Mexico, for example, in the development drive and export success that they have had through the 1970's and even today, if one realizes the debt problem was largely an external shock for the Latin American countries, the things that seem to distinguish these success stories is precisely the combination of the two.

I think these countries, what really distinguishes them, is the fact that they had some sort of strategic design about the future. They had some idea of where they were headed. They had continuity of government for political reasons, but the most important thing is that they had a strategic design which was really quite specific in industrial policy content. They solicited the support of the private sector, then they targeted those very same sectors as

export sectors and subsidized them in the Korean case, the clearest of the three—they subsidized the exports, they subsidized investments to the major industries as they were trying to develop, but they also very clearly gave signals to the private sector they would respect market prices.

They, by and large, made efforts to get the exchange rate right. If they subsidized interest rates in one period, they raised them in the next. What you see are adroit cases of economic policy in these countries, both to set direction and to implement supportive policies that stimulated the private sector, brought the private sector in behind this strategic design and brought them rapid industrialization and exports.

So it seems to me that to conclude, as many people unfortunately I think have, that Singapore, Korea, and Taiwan have achieved their success because of the fact that they have adopted market liberalizing policies internally, so that outward orientation is equated with internal liberalization, exposing prices to market prices in the world economy and making your prices internationally competitive, is a stereotyping of these economies which is not only wrong in its interpretation but is fundamentally misleading in terms of the kinds of policies that countries are now trying to adopt as they cope with severe difficulties the world economy confronts them with.

I think debt-ridden countries are cases in point. What is required here, as I am sure your earlier hearings have shown, is some combination again of longrun and short-term outlooks on the part of these countries. They need to be very clear about where their future exports are coming from. Because they need to be clear about where their exports are coming from, they need to have a sectoral design such as Taiwan, Singapore, and Korea did. They need the martial support behind that sector design in order to assure that the production is there.

They need also to get their exchange rates right and to get prices right within their economies. They need to have short-term macroeconomic policies support that longrun industrial policy, sectoral policy design and their insertion into the international division of labor overtime in order to attenuate the debt problem.

This is what I call the policy nexus, the joining of the short-run macroeconomic policies in relation to the longer term structural sectoral design which has been the key to the success stories in East Asia and is the key element for the success of the transition that a number of important developing countries need to make in the future with the support of the Bank and the Fund.

So that we go back again to the point I made a minute ago, that if the Fund is increasingly a single window operation and if the Fund and the Bank are taking more seriously than I frankly think they should the stylized version of the East Asian success stories, then you have a set of institutions which are both disjointed in terms of the instrumentalities which they have before them, the Bank concentrating on the long-term development goals and the sectoral goals that the country may have, the Fund focusing on the short-term macroeconomic imbalance and balance of payments problems and inflation problems, and it being very difficult to join those two in some coherent and supportive fashion. I think that is

a very real problem both in the thinking that is going on in the Bank and the Fund, the stylization of the East Asian success stories and in the instrumentalities themselves.

I was thinking earlier this morning how I might bring this home to you, this disjuncture that I feel, and it occurred to me that in a way the Bank and the Fund have an analogy in the Senate and the House, and that the Senate basically is analog to the Bank because of its longer term outlook and the 6-year terms, and the Fund has its analog in the House, as you all appreciate better than I.

I think this single-window problem, I can dramatize it to you if I could suggest that what it comes down to is if somebody passed a law or decree that said that House Members could only serve for 3 years and they had to be reelected every year, and I think the kind of noose that you would feel yourselves in if you had to be reelected every year and if you could only serve for 3-year terms is illustrative, I think, of the problem that National Governments in the developing world particularly, but other countries as well, feel when the power and concentration of resources of these international institutions are harnessed to this single-window concept that I mentioned.

I just leave that with you as a means of trying to dramatize what I think is a very real problem. Underneath it all, I think, one has to realize that it is not the case that these governments by and large are trying to get away with easy policies. My experience with developing countries is that many of these governments are very serious about making corrections, and so it isn't a question of having to force them to the trough, it is a question of designing instruments which support their efforts to establish a viable policy.

I think that some changes encouraging the Fund to have a more medium-term outlook in both its policy outlook and in terms of the use of its instruments and encouraging the Bank to have a more broad view of what constitutes successful development policies could be very helpful in this regard.

Thank you.

[The prepared statement of Mr. Bradford follows:]

TESTIMONY

COLIN I. BRADFORD, JR.

Associate Director

Yale Center for International and Area Studies

before

U.S. House of Representatives

Committee on Banking, Finance and Urban Affairs

Subcommittee on International Development

Institutions and Finance and

Subcommittee on International Finance,

Trade and Monetary Policy

July 25, 1985

Increasing IMF/World Bank Cooperation

The International Monetary Fund (IMF) and the World Bank (IBRD) are the world's premier international economic institutions. In the mid-1980s, they each play a vital role in the global financial system and in world economic development. It is the highly interactive relationship between international financial patterns and the world economic outlook which make the relationship of these two outstanding institutions a subject of great importance. Not only do the financial prospects and growth outlook interact at the country level when the Fund and the Bank design

stabilization and development lending programs in specific country circumstances, but there is a great awareness now of the degree to which the interaction of financial and output-employment (or real) dimensions of the world economy affect overall global trends and patterns. The Fund and the Bank play major roles in at the global level not only in the quantitative sense of the aggregate importance of the financial flows and development assistance available through the two institutions, but also in the analysis that each presents of global prospects and policies through the annual World Economic Outlook published by the IMF in the spring and the World Development Report published by the Bank every summer. The research, data gathering and analytical capabilities of these two institutions is of exceptional quality. As a consequence, these reports are of great importance in global discussions and perceptions of world economic patterns and should be examined seriously. The economic research undertaken by the staffs of the two institutions and published in working papers and ~~journals~~ is of very high reputation and highly regarded in academic circles around the world.

The Bank and the Fund have come to have another role at the global level which is as convener of international discussions of ministers of finance on world economic problems. As you know, the Bank-Fund annual meetings in September have always been opportunities for informal discussions and formal declarations on international economic issues, but there has been a gradual evolution of the importance of the ministerial advisory committees of the Fund and the Bank, known as the Interim Committee¹ and the Development Committee.² These took on new significance

this spring through joint meetings of both committees in April which occurred because of "a growing recognition now of the indissoluble link between trade, development and finance."³ The meetings, while not leading to any major policy break-through, were quite successful in moving international economic issues toward points of policy action. Some of the major highlights reported in a joint press conference following the meetings given by H. O. Ruding, Chairman of the Interim Committee, Ghulam Ishaq Khan, Chairman of the Development Committee, Jacques de Larosiere, Managing Director of the IMF and A. W. Clausen, President of the World Bank were the following:⁴

- expressions of a sense of shared responsibility among developed and developing countries for world economic growth and, in particular, for resolving the debt issue
- recognition of responsibilities of the major industrial countries for curbing or reversing protectionism, lowering interest rates through the right type of policy mix, the importance of seeking greater exchange rate stability and adequate financial flows
- readiness to join with the banking communities in multi-year debt rescheduling agreements
- clear support for strengthening Fund surveillance over economic and financial policies of all member countries in a uniform, even-handed way
- recognition that the developing countries would not be convinced of the seriousness and usefulness of the new

round of trade negotiations until such time as they have an indication that the developed world is prepared to deliver on its past promises

** political support to move forward with a Multilateral Investment Guarantee Agency

** the desirability and the need for a resumption of export credit cover

** expression of the need for support for IDA and World Bank roles in lending to developing countries with special concern for the situation in sub-Saharan Africa.

These are not earth-shattering steps (some of them are not steps at all) but the sense of movement was significant. The effectiveness of these committees of the Bank and Fund in promoting these discussions probably derives from the participation of ministers of finance in them (which is customary even when the committees deal with only Fund or Fund-Bank related operational issues), the relatively small size of committees (22 governments are represented in the Interim Committee, 21 in the Development Committee) and the fact that both developed and developing countries are represented.⁵ The joint meetings of these committees illustrates the urgency of dealing with the different elements of the world economy in their conjuncture rather than separately, even if a capacity for decisive action was not forthcoming, especially regarding the most crucial issues affecting global prospects, namely domestic economic policies of industrial countries. Nevertheless, these committees may constitute "a forum where understanding can be reached on the problems that confront the various

parts of the globe."⁶ The Bank and the Fund not only provided institutional but also substantive support for these meetings, a further manifestation of their capacity for addressing the broad context in which their operational activities occur.

As far as Bank-Fund cooperation is concerned, then it seems to me that these institutions have done all that they can do in providing a trusted and effective form -- and one certainly that is at least as useful as the economic summits. What is missing is not a manifestation of any weakness in cooperation between the Fund and the Bank, but rather the failure of major governments, most notably our own, to fully understand the international implications of its domestic policies. The United States is particularly flagrant in its failure to be fully consistent in its own domestic policies with the criteria of economic policy it is so clearly supportive of through these institutions in establishing norms for stabilization policies in other countries. The U.S. is a leader in its advocacy of fiscal balance and market prices globally but is setting, by its own example, a totally different standard of policy conduct. Instead of providing leadership in the establishment of consistent norms for domestic policies as a basis for international economic relations, the U.S. is saying one thing and doing the opposite. This, more than any other single factor, destabilizes the world economy, generating particularly acute pressures in two regions of major importance to the United States -- Europe and Latin America -- while simultaneously undermining the role the Fund and the Bank are able to play in promoting domestic policies that are consistent with the requirements of the new global economy of the 1980s.⁷

Just as the Fund and the Bank have recognized and played an active role with respect to the integration of different elements in the world economy at a global level, so too there is a need to recognize the centrality of this integration at the national level and its relationship to international capital requirements, term structures of international finance, and advice on development strategies and economic policies that are fundamental responsibilities of the Bank and the Fund. The assertion here is that national governments are dealing with several facets of economic policy simultaneously, not separately, and that as a consequence there is need for the channels of international finance and the thinking behind them to mesh more effectively with the instruments and concepts of economic policy as they are carried out by national governments.

In the 1970s, economic stabilization became a global problem.⁸ In the 1980s, economic performance became more differentiated regionally. Despite these more differentiated patterns, stabilization remained a priority goal for most governments, both as a matter of controlling inflation internally and managing the balance of payments externally. Nevertheless, there was a shift in emphasis between the 1970s and 1980s. Whereas in the 1970s stabilization policies and programs were driven more by inflation, balance of payments disequilibria and debt have been the principal driving forces in the 1980s. The inflation driven stabilization problems of the 1970s raised an issue of the degree of internal determination versus the extent

of external transmission.⁹ Economic stabilization issues in the mid-1980s, however, seem clearly linked with the degree of openness of national economies, the degree of interaction between trade, macropolicy and financial patterns, and the degree of interdependence among major nations in the world economy, including now new powers from the developing and socialist worlds.¹⁰ This open economy dimension is a major distinguishing characteristic of the stabilization problems in the mid-1980s.

A second major characteristic is the degree to which stabilization problems and policies are now embedded with structural issues related to growth, industrial policy, and the international division of labor. Despite the differentiation in economic performance recently, most governments today are struggling with the goals of economic growth, stabilization and restructuring of their economies simultaneously. The tensions and trade-offs between growth and stabilization are well-known in policy experience and in the literature. The new element of restructuring has become a matter of equal policy priority precisely due to the increasing openness, systemic interaction of real and financial variables, and interdependence characteristic of the world economy today. The pressure on industrial structures due to rapid technological change and diffusion and to the transnationalization of both production and financing is global. France, the United States, Poland, Brazil, Korea and Japan are struggling in different ways and distinct circumstances with the same set of policy issues: the balance between growth, stabilization, and restructuring.

A preoccupation with one of these policy goals to the exclusion of the

others invites disaster, as the early Mitterand years and the Southern Cone experience would seem to indicate.¹¹ The embedding of the restructuring issue within the more conventional macroeconomic framework gives economic policy a decidedly medium-run horizon. In this case, developing countries are more accustomed to working through the nexus of short-run macro-economic policies with longer run development strategies than are advanced countries. This is true due to the tradition of development planning in developing countries over the last three decades. But it is also attributable to the pressures of the debt burden on important LDCs that force a longer term framework for scheduling debt payments and projecting export earnings. The need to export adds to already existing pressures to find a niche in the international division of labor through the design of sectoral development strategies that are consistent with internal endowments and capabilities and with the rapidly changing structure of trade relations. Longer term financial planning, sectoral development strategies and export requirements play a more decisive role in shaping short-run macroeconomic policies. In turn, macro policies have a crucial bearing on the realization of the longer term goals. Therefore, the sustainability of short-run macro policies is critical to the viability of the longer run trajectory just as the long-run trade and financial requirements affect short-run policies. Hence, achieving a sustainable balance between growth and stabilization in the short-run as a matter of policy becomes inseparable from the longer term dimensions. This policy nexus of growth, stabilization and restructuring is the pivot point around which international financial flows and development assistance need to

relate.

Given this synthesis of economic policy with development policy, the following questions arise: (1) do the financial flows available from the Fund and the Bank relate to the policy nexus in a supportive fashion? and (2) are the intellectual approaches attendant to the respective financial resources of the Fund and the Bank reflective of the policy reality facing member governments?

My view is that there are some problems in both the realm of instrumentalities and in the realm of ideas in this regard. The difficulties in the instrumentalities are that the institutional constraints and, probably more important, the political thrusts of industrial country governments are in the direction of maintaining the separate and distinct functions of the Fund and the Bank rather than facilitating the integration of medium to long-run with short-term policy perspectives. The Fund in recent years has moved from a more open-ended, medium term perspective in the late 1970s to a more restrictive short-run orientation whereas the Bank is charged with long-run development responsibilities. This creates some difficulties in shaping economic policies and meshing Fund resources, which must be repayed in 1 to 3 years, with Bank resources which have repayment periods of 15 to 20 years. The Group of 10 (the industrial countries) approved in Tokyo in June a Deputies Report chaired by Lamberto Dini which states "the strengthening of cooperation (between the Fund and the Bank) should not be in the direction of transforming the IMF into a channel for long-term finance or of shifting

the IBRD away from its primary focus on development financing."¹²

This position is consistent with the position of the Reagan Administration since the beginning. Just prior to the annual meetings of the World Bank and the IMF in September 1981, Treasury Secretary Regan was reported as having said, "that the conditions imposed by the Fund in making loans to poorer countries had become lax in recent years and should be made 'more strict'." (NYT 9/22/81) In October 1981, the IMF cut off credit to Bangladesh in a move reportedly related to "pressure from the Reagan Administration to tighten its lending policies." (NYT 10/30/81). In November 1981, the U.S. abstained in a vote in the IMF Board after failing to get enough support to block a \$5.5 billion Extended Fund Facility (EFF) loan to India. The U.S. was said to have "strong misgivings...that the money would be...more for development purposes than for meeting specific balance of payments needs." (NYT 11/10/81).

The institutional or political problem manifests itself economically in the short leash on the Fund's resources. The Extended Fund Facility of the IMF was established in 1974 to provide medium-term assistance to overcome serious structural balance of payments maladjustments. It became important quantitatively only from 1982 on, when EFF annual purchases reached between 2.5 and 4.7 billion SDRs. The most significant decisions were EFF arrangements with India (5 billion SDRs), Brazil (4.2 billion SDRs) and Mexico (3.4 billion SDRs) all for three years. In the 1981/82 financial year ending April 30th 1982, 15 countries made purchases under EFF arrangements, 9 in the 1982/83 financial year and 11 in the 1983/84 financial year. As of April 30th 1984 extended arrangements were in effect

in only five countries, with undrawn commitments amounting to SDR 6.2 billion, compared with SDR 11.5 billion under nine arrangements a year earlier.¹³ There appears to be a general trend toward a more limited number of extended arrangements involving less Fund resources than previously.

The policy on enlarged access enables Fund members to have access to additional resources in cases where "balance of payments imbalances are large in relation to their quotas" and where members "need resources in larger amounts and for longer periods than are available under the regular credit tranches."¹⁴ Whereas the original arrangements decided on March 11, 1931 were for drawings of up to 150 per cent of a country's quota, 450 per cent for three year periods and a cumulative total of 600 per cent, these were reduced in 1954 to annual limits of 102 or 125 per cent, three year limits of 300 or 375 per cent, and cumulative limits of 408 or 500 per cent, "depending on the seriousness of the member's balance of payments needs and the strength of its adjustment efforts."¹⁵ Whereas in 1931 the policy of enlarged access represented a 12 1/2 per cent increase in the absolute amounts of assistance available, the 1954 decision represents a reduction of potentially a third of the resources that would have been available under the 1931 guidelines, along with additional discretion on the part of the Fund as to the amount actually accessible.

In September 1983 the Executive Board of the Fund introduced new guidelines "as a result of which the conditionality of purchases under [the Compensatory Finance Facility] is brought more closely in line with that applying to purchases in the credit tranches."¹⁶ The Compensatory

Finance Facility provides financial assistance to members "experiencing balance of payments difficulties arising from temporary export shortfalls and/or from increases in the cost of cereal imports caused by factors largely outside their control." Simultaneous with the introduction of conditionality negotiations consistent with stand-by arrangements in replace of what was intended to be a more or less automatic triggering of drawings, the size of the drawings in relation to quotas were also reduced. Sidney Dell has written that the September 14, 1983 decision on the CFF "destroys the basic purpose of the facility." He goes on to say that "from now on the burden of adjustment must be shifted by the Fund entirely to the countries that are victims of such external pressures."¹⁷

Without going through more details, I think it is clear that there is a drift, if not indeed an actual trend, in the direction of more restricted access to Fund resources toward more conditionality and shorter term instrumentalities. The conventional one year stand-by arrangement with short-run policy conditions is the predominant instrumentality to which the newer, more flexible instruments brought into being in the 1970s and early 1980s are being tied. One could argue that the Fund is in effect becoming a one-window operation.

This creates a problem for the countries in that it forces a one year outlook on macroeconomic policy as distinct from the longer run perspective for development policy. It makes it more difficult to inter-relate the two realms of policy. As a consequence, Bank and Fund lending tend to be channeled toward separate rather than coordinated goals. If Fund resources were available for 3 to 5 years, the macropolicy outlook and the

development policy perspective would overlap and be brought into closer synchronization both internally and in the channeling of external financial flows. This would help make economic policies more effective and achieve more coordination of Fund and Bank financial resources.

III

This trend in the use of Fund resources as separate from the longer-term development uses of World Bank lending is, of course, a reflection not only of the policies of important industrial countries, including most particularly, the United States, but also of the intellectual approach to policy which is predominant at this time in history. In the wake of the development of the welfare state in the West and the rise of fiscal deficits as a generalized problem, there has been a reaction which argues in favor of a reduced role for the state in the economy and an enhanced role for market forces. This reaction in the West has been given further encouragement by the emergence of the East Asian success stories of Hong Kong, Singapore, Taiwan and Korea and the interpretation of their success as having been market driven.

Staffan Linder summarizes this thinking as follows:

"Explanations stressing the importance of market system and capitalist methods in the development of the Asian-Pacific countries have now gained wide currency. This will yield what may be called an ideological effect. Political thought and economic thinking will be influenced in the old industrial countries where faith in the system which once brought these countries their wealth, is again rising after a long period of erosion."¹⁰

The ascendance of the East Asian success stories and the

interpretation of their achievement has led to an ideology of development success. In explaining why the economic growth of the Asian-Pacific countries have out paced that of other countries, Helen Hughes observes that:

"The only hypothesis that explains why some developing countries have grown rapidly, while others have not, links the adoption of a positive development philosophy with a policy framework that leads through market mechanisms to efficient resource allocation and utilization."¹⁹

Whereas the 1970s were a period in which success stories occurred in Latin America (Mexico and Brazil), in Southern Europe (Portugal, Spain, Turkey), in Eastern Europe (Yugoslavia, Poland, Hungary) as well as East Asia, the greater exposure of Latin America to financial shocks due to its large variable interest rate debt has led to a stylized contrast between the development trajectory of East Asia and Latin America. The stylized version highlights the inward oriented, interventionist, import substituting policies of Latin America resulting in high price distortion, low growth, low export growth, and high incidence of debt rescheduling. The East Asian model is seen as one of outward oriented, market driven export promotion based on internal liberalization and low price distortion, resulting in high growth, high export growth, and low incidence of debt rescheduling.²⁰

This stereotyped contrast fits well with the short run demand management stabilization policy outlook of the IMF. In in the late 1970s there had been greater flexibility in policy approach of the Fund, most notably in the Executive Directors guidelines for conditionality in March 1979 which embodied not only the possibility of medium run stand-by

arrangements but also more sensitivity to social and political constraints and more openness toward supply side dimensions of policy emphasizing additional investment and economic growth. The recent predominance of the more orthodox concerns for price stability and balance of payments equilibrium overshadowed the structural elements in the 1980s leading The Economist to observe in 1983 that:

"Increasingly, (the IMF and World Bank) have found themselves embroiled in the same set of policy issues: how can economies grow even when the international climate is unfavorable? The answer that the Fund and Bank give can be summed up in four words: get the prices right."²¹

The idealization of the East Asian model as having succeeded in development through getting prices right for resource allocation reasons and the shift toward demand management stabilization policies that emphasize getting prices right to achieve balance of payment equilibrium constitute a consistent policy package. Both emphasize the need to give priority to removing import controls and adjusting the exchange rate to bring internal prices into alignment with world market prices. Both emphasize price stability and open markets prior to economic growth and export promotion. Both argue that the costs of the new orthodoxy of liberalization and conventional stabilization will be compensated for by balance of payments equilibrium and efficiency gains in the short run and by export led growth in the longer run.

As a result, the separation of the instruments of the Fund and the Bank is seen undoubtedly as unimportant because the short run requirements of conventional stabilization are consistent with the policy reforms based on the East Asian model necessary for success in the long-run. There is in

the end, it could be argued, a new conventional wisdom about stabilization and development -- a new consensus which gives the Fund and the Bank a single, uniform policy approach.

Closer study of the East Asian economies reveals a different picture of the reason for their success. It is a more complex story and not so easily told or summarized, as is necessary here, but it is precisely this complexity that creates some doubt about the advisability of generalizing from the East Asian cases as a model for economic policy. First, there are differences among the four principal success stories -- Hong Kong, Singapore, Taiwan and Korea. Of the four, Hong Kong is the closest fit to the stylized version; Korea is probably the furthest removed.

Secondly, there are different phases in the development story of these four countries in which the mix of factors has shifted over time so that what is true in one period gives way to a different configuration in the next period. Albert Hirschman observed many years ago in the the British journal, Encounter, that thinking about policy is frequently out of phase with the policy reality. This is exacerbated today by the lags necessarily involved in publishing results of major research projects. Three major studies of development policy became available in the late 1970s when attention was being focused on the East Asian success stories and other newly industrializing countries (NICs).²² These research endeavors focused largely on the experience through the mid 1970s which largely fit the stylized version in which there was a shift from import substitution industrialization to export-led growth which appeared to coincide with a shift from government intervention to internal liberalization. In the

1980s, research on the experience of the decade of the 1970s generally reveals a more complex story involving a mix of private market forces and public sector actions which overall yield a more dirigiste cast to the success story. This general conclusion too is out of phase because in the mid 1980s as the more balanced story of the 1970s is being highlighted, there is indeed a shift occurring in several countries toward more reliance on markets.

Let me illustrate briefly. Wontack Hong estimates that "the annual provision of credit subsidies in Korea amounted to at least 10 per cent of GNP each year on average in the 1970s."²³ He concludes that "the increasing exports of highly capital-intensive goods may only be explained by the extensive subsidies on capital use in Korea in the 1970s."²⁴ Credit rationing to preferred sectors accompanied this subsidy action. Targeting sectors and establishing export targets for specific industries played a significant role.²⁵ Hong finds that the nine largest general trading groups increased their share of total commodity exports from 15 per cent to near 50 per cent from the beginning of the 1970s to the early 1980s and that this increased concentration was "at the expense of the share of small and medium size exporting firms."²⁶ This is not exactly an Adam Smith story of the invisible hand operating in the atomistic market place of small firms. Although these policies had a major effect on the success story of the 1970s, they had some negative effects that are being corrected in the 1980s.²⁷

The Korean development story is not dissimilar from the Brazilian case which also relied heavily on the involvement of the government in the 1970s

in achieving an export boom that began in 1967 and entailed a major expansion in the export of manufactured goods. There is a movement now in Brazil toward a more realistic exchange rate, a more realistic interest rate, cutting subsidies, mobilizing internal savings, reducing the public sector deficit, and providing incentives for private sector innovation and investment. Brazil is trying to continue the export promotion strategy that it had in the 1970s at the same time seeking new opportunities for import substitution.²⁸

The Korean case also was characterized by import substitution industrialization along with export promotion. A French study comparing Mexico and Korea shows clearly that import substitution took place in sectors that were initially protected and then moved towards production for the export market in later phases and in which first stage export industries spurred downstream industries such as steel which eventually produced for export.²⁹ The dichotomy between export promotion and import substitution is overdrawn in both the Brazilian or Korean cases during the 1970s nor does it characterize their current strategies.

Taiwan is also an interesting story from the perspective of the mythology of the East Asian success story. Taiwan has had a trade regime which involved very selective management of both the volume and composition of imports to boost the technological capability of the economy. Fiscal incentives were highly selective by product reflecting a clear sectoral strategy on the part of the government as a means of changing the structure of the Taiwan economy. Even though the banking system was government owned, credit allocations were less prevalent in Taiwan than in Korea. On

the other hand, public sector enterprises constituted almost a third of fixed capital formation in Taiwan as opposed to slightly more than a fifth in Korea. Government as a percent of GDP was as high as 30% in the mid-70s in Taiwan as opposed to 19% in Japan. In Taiwan there was also a strong effort to keep macro policies in balance so that the exchange rate and interest rate were realistic and inflation was kept low. This, along with other measures, helped to keep the prices of labor, capital and other factors of production close to scarcity prices, so that market prices were realistic in terms of real value.³⁰

Import substitution in the Taiwan case was also found to accompany rather than simply precede export promotion. As Chi Schive puts it:

"during the last two decades, the great success of export-led economies in East Asia, in particular Taiwan and South Korea, has led critics to label import substitution as inefficient, unnecessary, and even a sin...The results (of his analysis of Taiwan from 1966 to 1976) show that secondary import substitution is clearly present at the industrial level during the period when Taiwan's exports increased rapidly."

Schive goes on to say that "secondary import substitution industries in Taiwan seem to have been developed with little policy intervention (a full investigation of this question is suggested -- Chi Schive) and that the sequence of import substitution in Taiwan is directly in line with the backward linkage hypothesis"³¹ whereby downstream industries are spurred by dynamic final goods sectors.

The Taiwan development story, then, is very difficult to stereotype either as a market oriented success story or as an illustration of the triumph of dirigisme and policy intervention. It is a mixture of both elements in effective and powerful interaction which characterizes this

case, as it is also the mix of import substitution and export promotion rather than their sequencing which was important.

Singapore seems to be another case of development mix rather than dichotomous choice. Chung M. Wong points out that "although Singapore has relied mainly on private enterprise, the government has tried to influence resource allocation in various ways -- such as providing incentives to industries regarded as desirable for the country. In fact, Pang and Tan (1981, p. 151) single out the government as the most important factor behind Singapore's economic success."³² He goes on to say:

"At present the "pioneer status (with relief of 5 to 10 years from the 40% tax on profits arising from an approved pioneer activity) and the investment allowance incentive (with tax deduction equal to up to 50% of new fixed investment in plant, machinery and factory buildings) are the main incentives used in investment promotion. Pioneer certificates are now mainly awarded to projects manufacturing new and high-technology products, while the investment allowance incentive is increasingly being used to promote the upgrading and mechanization of existing operations. Tax incentives are also given to encourage manufacturers to undertake research and development activities. Projects believed to be of strategic importance to Singapore's industrial development can obtain long-term fixed rate loans at favorable interest rates under the Capital Assistance Scheme (CAS) administered by the Economic Development Board."³³

Ralph C. Bryant describes a similar set of circumstances -- "the gradual extension of incentives and dismantling of constraints" -- as part of Singapore's "aggressive development policies," "a conscious and active policy to create an environment for financial activity to flourish."³⁴ This priority to the development of the financial sector included favored regulatory and tax conditions.

Given this background, it seems a bit overdrawn to conclude: "That in South Korea and Taiwan, growth did not really start until around 1960 when, in both countries, there was a far reaching redirection of economic

policies away from regulation and interventionism over to a reliance on market mechanisms³⁵ (Linder), or that "the East and Southeast Asian experience suggests that if the basic policy framework is appropriate, only limited sectoral policies are required to stimulate areas of actual and potential comparative advantage"³⁶ (Hughes).

The stylized version of the East Asian success stories meshes with the conclusions of the price distortion research found in the World Bank World Development Report. The research concluded that high price distortion was associated with low growth and, conversely, low price distortion was associated with high economic growth. If the commitment to an outward oriented growth strategy is construed to mean internal liberalization, then adopting the stylized version of the East Asian model will achieve high economic growth through both efficiency gains and increased exports.

Not only does the actual history of the East Asian NICs differ from the stylized version but one must question the inferences drawn from the price distortion research. It must be asked whether an aggregate index composed of several weighted indexes covering the decade of the 1970s can adequately or accurately measure price distortions. Simple grouping of countries according to inward and outward oriented and averaging key price distortion indexes and growth performance does not lead to the expected results, casting doubt on the conclusions.³⁷

The implications of these findings and the more complex background on the East Asian NICs is that it seems difficult to justify the new conventional wisdom on development policy. The real story of what makes for successful development is more complex than the stereotypes suggest.

In the end, market forces and policies matter; import substitution and export promotion occur simultaneously and in a more supportive relationship than is generally supposed. In the name of even-handedness, it is not a helpful circumstance to have our premier international financial institutions wedded to a single model of what constitutes a successful development policy or to a narrow definition of what constitutes an effective stabilization program. It seriously undermines the role of the Fund and the Bank in the world economy by restricting their scope and their effectiveness. It politicizes them by having them represent, what Linder has rightly pointed out is, an ideology, when their role is to be responsive to a variety of types of governments and economic systems.³⁸ In my judgement, the most serious result of the formation of the new conventional wisdom and the degree to which it has either been imposed on or embraced by the Fund and the Bank is the degree to which this set of ideas and the molding of Fund-Bank instrumentalities in accordance with them, restricts the freedom of national governments around the world to determine their own policies and shape their societies in accordance with their distinct values and traditions. Lost in the trumpeting of the East Asian success stories is the thinking by serious people who recognize the excesses of intervention, who are concerned by overburdening the role of the state, who believe that getting prices right is an important part of development and who nevertheless see national economic policy and the state as crucial instruments for shaping the destiny of their countries according to national norms.³⁹ Given entrenched interests, structural problems and a highly fluid international environment, the state and its

economic policies can be vehicles for enhancing freedom, self-determination and democratic values. Single formula solutions are confining at best and undermining at worst to policy makers who are seeking to balance short-run and long term requirements, stability and growth, real and financial dimensions in defining their nations' futures and their roles in the world economy.

These great international institutions need to be given more flexibility and diversity in both their instrumentalities and their policy outlooks to deal with the world economy today and the variety of policy mixes that, in different complex circumstances, are effective in coping with the economic challenges facing national leaders in the mid-1980s.

FOOTNOTES

- ¹ Formally known as the Interim Committee of the IMF's Board of Governors on the International Monetary System
- ² Formally, the Joint Ministerial Committee of the Bank and the Fund on the Transfer of Real Resources to Developing Countries
- ³ Ghulam Ishaq Khan, "Adjustment and Growth: A Cooperative Approach," Finance and Development, A Quarterly Publication of the International Monetary Fund and the World Bank, June 1985, Vol. 22, No. 2, p. 7.
- ⁴ IMF Survey, May 13, 1985, pp. 156-159.
- ⁵ The Development Committee -- Its First Ten Years 1974-1984
- ⁶ Fritz Fischer, "The Spring 1985 meeting of the Development Committee," Development and Finance, June 1985, p. 9. (Mr. Fischer is Executive Secretary of the Development Committee.)
- ⁷ Colin I. Bradford, Jr. "National Autonomy and the New Globalism" in Colin I. Bradford, Jr. (ed.) Europe and Latin America in the World Economy, New Haven: Yale Center for International and Area Studies, 1985.
- ⁸ William R. Cline and Sidney Weintraub (1981), Economic Stabilization in Developing Countries, Washington, D.C.: The Brookings Institution; and William R. Cline and Associates (1981), World Inflation and the Developing Countries, Washington, D.C.: The Brookings Institution.
- ⁹ Surjit S. Bhalla, "The Transmission of Inflation into Developing Economies," Cline and Associates (1981), pp. 52-101.
- ¹⁰ Colin I. Bradford, Jr. (1985), "New World Economy" section of "National Autonomy and the New Globalism" in Colin I. Bradford, Jr. (ed.), 1985, Europe and Latin America in the World Economy, New Haven: Yale Center for International and Area Studies, pp. 7-14.
- ¹¹ Nicolas Ardito Barletta, Mario I. Biejer, Luis Landau (eds.), Economic Liberalization and Stabilization Policies in Argentina, Chile, and Uruguay: Applications of the Monetary Approach to the Balance of Payments, The World Bank, Washington, D.C., 1983.
- ¹² IMF, IMF Survey (Supplement), July 1985, p. 12.
- ¹³ IMF, Annual Report 1984, pp. 76-77.
- ¹⁴ IMF, Annual Report 1981, pp. 85-88.
- ¹⁵ IMF, Annual Report 1984, p. 78.
- ¹⁶ IMF, Annual Report 1984, p. 79.

- 17 Sidney Dell, "The Fifth Credit Tranche," World Development Vol. 13, No. 2, 1985, p. 245 and p. 247.
- 18 Staffan Burenstam Linder, "Pacific Protagonist -- Implications of the Rising Role of the Pacific," American Economic Review, Papers and Proceedings, May 1985, p. 280.
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- 20 World Bank, World Development Report 1983, pp. 57-63, and World Development Report 1984, pp. 54-55. See also Morgan Guaranty, World Financial Markets, September 1983.
- 21 The Economist, September 24, 1983, p. 39.
- 22 J. M. D. Little, T. Scitovsky and M. Scott, Industry and Trade in Some Developing Countries: A Comparative Study, Oxford: Oxford University Press, 1970.

Bela Balassa, "Export Incentives and Export Performance in Developing Countries: A Comparative Analysis," Weltwirtschaftliches Archiv, Vol. 114, 1978.

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- 24 Wontack Hong, ibid. p. 18 and p. 29 and *passim*.
- 25 Yung Wnee Rhee, Bruce Ross-Larson and Larry Pursell, Korea's Concessions, The Johns Hopkins University Press, 1984, Chapter 3.
- 26 Wontack Hong, ibid. p. 40.
- 27 "South Korea: A Special Economic Report," The International Herald Tribune, Paris, October 6-7, 1984.
- 28 Peter T. Knight, "Economic Stabilization and Medium Term Development Strategy in Brazil," Washington, D.C. February 1985; and Persio Arida, "Economic Stabilization in Brazil," Latin American Program, The Wilson Center, Washington, D.C. Working Paper No. 149, 1984.
- 29 Centre d'Etudes Prospectives et d'Informations Internationales, Crisis Mexique: Deux Expériences de Développement Face à la Crise, La Documentation Française, Paris, 1982.
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 - 33 Ralph C. Bryant, "Financial Structure and International Banking in Singapore," Brookings Discussion Papers in International Economics, May 1985.
 - 34 Steffan Linder, op. cit. p. 280.
 - 35 Helen Hughes, op. cit. p. 17.
 - 36 Colin I. Bradford, Jr., "The NICs: Confronting the U.S. Autonomy," in Richard E. Feinberg and Valeriana Kallab (eds.), Adjustment Crisis in the Third World, New Brunswick: Transaction Books, 1984, esp. pp. 121-126.
 - 37 Jagdish Bhagwati registers a similar concern by comparing the 1950s and 1960s when there was in his view "a certain tolerance of differing political preferences of individual countries and for basic differences in economic policy mix that these countries might opt for," and the 1980s. "The Reagan administration's revisionist approach to North-South relations was twofold.
"It not merely sought to reverse what it perceived as an ideological surrender to statism and intervention in the different multilateral agencies via their very existence or through their methods of functioning. It also proceeded, in consequence, to become intolerant of the pluralistic political and economic approaches to development.
"The conviction with which the advantages of the invisible hand, and the disadvantages of the visible hand, were propagated and sought to be imposed on the faithless infidels whenever possible tempts one to describe this period as The Age of Certainty."
- Jagdish Bhagwati, "Ideology and North-South Relations," Bernard Fain Lecture, Brown University, April 18, 1985.
- 38 See Enrique V. Iglesias, "Latin America: Crisis and Development Options" and Aldo Ferrer, "Debt, Sovereignty and Democracy in Latin America: The Need for a New Orthodoxy," in Colin I. Bradford, Jr. (ed.), Europe and Latin America in the World Economy, op. cit. pp. 44ff.

Chairman LUNDINE. Thank you, Mr. Bradford. You got our attention not only by your analysis but by your analogy.

Mr. Dale.

STATEMENT OF WILLIAM B. DALE, INTERNATIONAL ECONOMIC CONSULTANT AND FORMER DEPUTY MANAGING DIRECTOR OF THE INTERNATIONAL MONETARY FUND

Mr. DALE. Thank you, Mr. Chairman. Thank you for inviting me this morning.

I thought, too, about an analogy between the House and Senate in describing how difficult it is at times for the Bank and the Fund to collaborate effectively. I didn't go beyond and adumbrate that thought as Mr. Bradford did. I agree with much of what he has to say and, in particular, with the theme that he put forward that the principal issues and the response to them of the Fund and the Bank do not relate primarily to effective coordination between those two organizations viewed in a narrow sense, but rather to the behavior of member countries and the national policies that impinge so heavily on international considerations and other countries.

In my own statement, I have focused on the more narrow question of collaboration and coordination between the Fund and the Bank and mostly I have given background on it. For that reason I will be brief in summarizing it.

I point out that actually both before the Bretton Woods Conference and shortly after, during the time when the Bretton Woods legislation was in front of the Congress, there were ideas that were considered for the ultimate form of coordination between the two, namely to have a single organization instead of two. That was rejected by the U.S. Treasury in its 1942 publication of its own plans at that time for postwar international economic organizations.

Then in congressional hearings, it was a slightly different form. Many American bankers, including those who spoke for the American Bankers Association, opposed the creation of the IMF. They didn't oppose the creation of the World Bank, but for the IMF some of them suggested postponement of its creation. Some suggested not creating it at all, some suggested that it be created as a department or wing of the World Bank, all of which would have eliminated any questions of coordination.

That, of course was not done. It was created, as it had been negotiated, in 1944. There was then another set of questions. Should coordination be achieved by appointing the same individuals as Governors of the Fund and the Bank and/or as the Executive Directors in the Fund and the Bank? As you know, under the Bretton Woods legislation, the United States has always had the same individual; namely, the Secretary of the Treasury, as Governor of the two organizations. We have not had the same individual as Executive Director of the two organizations, although for a few years in the 1950's, there was an alternate director who was the same individual for both organizations.

A number of other countries did, however, appoint the same individual as Executive Director in the two. When I first joined the Board of the Fund in 1962, there were indeed 9 out of 16 individ-

uals who were dual directors, as we call them. Today and in recent years, there are only 3 who are dual directors out of 22 directors in the Fund and 21 directors in the Bank. That is not because countries have concluded the need for coordination between the two organizations is less than it was earlier. Quite the contrary. It is simply because with the increase in numbers of countries who are members of these organizations, there is a greater pressure and belief that there is need for a presence of as many countries as possible at these organizations, and also because the workload at both organizations has increased a very great deal over the years.

I might just give you a quote from the famous Lord Keynes who when presented with the suggestion that the same people ought to be directors in the Fund and the Bank made it clear that he thought it was a thoroughly bad idea. I quote: "I should like to see the Board of the Fund composed of cautious bankers and the Board of the Bank of imaginative expansionists."

So there you see that the creation of the two organizations, at least in that view, had a point and a purpose and that inherently there might be questions of coordination between the two. It is interesting, I think, that during about the first half of the history of the two organizations, as far as I can tell, the issue of coordination didn't become a very serious or thorny one between them. It wasn't until 1966 that written documents were first established on the subject of collaboration between them.

One was a document of January 1966, which was largely procedural, but then in December 1966, there was a set of documents, identical memoranda, by the President of the World Bank and the Managing Director of the Fund, which were sent to their Boards and endorsed by the Boards, which set forth the essential fields of activity of the two organizations in which one organization was to take the views of the other as the leading organization in that particular field. I have included as an attachment to my testimony the two principal paragraphs involved, because they were at that time, and they remain today the conclusive statements on that subject.

Well, Mr. Chairman, of course, especially over the last decade and a half, and particularly since the Fund established the first compensatory financing arrangement in 1963, and, second, the extended arrangement to which Mr. Bradford made reference, in 1974, and as the major change in energy prices and the relationship of energy prices to other prices led to sweeping changes in economic conditions, all of these circumstances plus the creation of the Development Committee and the Interim Committee and the creation by the World Bank of its structural adjustment lending program in 1980, these all have been events, along with a number of others, that have reinforced the need for effective collaboration between the two organizations. And indeed it has developed into something that takes place on a regular ongoing, consistent basis, something in which the managements of the two organizations, the staffs at all levels and the executive boards have taken a lot of interest, particularly in the most recent years.

I think it is obvious that for the immediate future, particularly the heavily indebted countries of Latin America and virtually all countries of Africa are areas in which this collaboration will be tested.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Dale follows:]

July 25, 1985

Statement
by
William B. Dale
before the
Subcommittee
on
International Development Institutions and Finance
and the
Subcommittee
on
International, Finance, Trade and Monetary Policy
of the
House Committee
on
Banking, Finance and Urban Affairs

Mr. Chairman, and members of the Subcommittee. Thank you for asking me to appear before you this morning.

My name is William B. Dale. I am a consultant in international finance. Perhaps of greater interest is that I served for some 21 1/2 years in the International Monetary Fund up to May 1984; more than 11 years were as the U.S. Executive Director in the Fund and more than ten years were as Deputy Managing Director of the Fund.

You, Mr. Chairman, have asked me to address a number of questions and issues about collaboration between the World Bank and the IMF and I am glad to do so. Before coming to the present and looking to the future, a few summary words of background may be helpful.

Relations between the Bank and Fund were considered before, and shortly after, the Bretton Woods Conference. Indeed, apart from assuming -- as I believe the founders undoubtedly did -- that the two new financial institutions in very closely complementary fields would naturally and of necessity work closely together, some of the principal founders actually considered the case for a single institution to cover the fields of the Bank and Fund. The idea was rejected in the April 1942 version of the U.S. Treasury plans for the postwar international financial order, as follows:

"Those two tasks should be kept distinct. Though in some of their facets and in many of their consequences there is considerable interdependence and interaction, the two are different enough to call for separate instrumentalities. Each is sufficiently specialized to require different resources, different responsibilities and different procedures and criteria for action...The best promise of successful operation seems to be in the creation of two separate institutions, linked together by one or two directors in common."

In 1945, in the Congressional hearings on the two organizations, many American commercial bankers opposed creation of the Fund, some suggesting its postponement, merger with the Bank or that the Fund should be a department of the Bank. However, the two institutions were created as negotiated in 1944 and my contention is that this was a good thing.

One charter provision, however, has a bearing on the subject at hand. The Articles of Agreement of the Bank limit membership to countries that already have become members of the Fund and if a Bank member leaves the Fund its Bank membership ceases in three months unless three quarters of the total voting power in the Bank supports continued membership in the Bank. It does not seem to be completely clear why this asymmetrical provision, which has no counterpart in the Fund Articles, was adopted. In my judgment, the most compelling reason would be the idea that countries should accept the surveillance of the Fund over their exchange rates and restrictions--or more generally that they adhere to the agreed international economic code of conduct--as a counterpart to having the benefit of long term reconstruction and development assistance from the Bank.

As mentioned in the April 1942 quotation above, one possible way to promote coordination between the Bank and the Fund would be to appoint the same individuals as Governors on the one hand, and Executive Directors, on the other hand, in the two institutions. This was suggested by a Congressional witness in 1945. Lord Keynes made it clear that, in his view, the idea of dual Executive Directors was a thoroughly bad one. "I should like to see the Board of the Fund composed of cautious bankers, and the Board of the Bank of imaginative expansionists." A number of countries, including the United States under the Bretton Woods Act, have the same individual as Governor of the two. Some years ago, quite a few Executive Directors were dual

directors. When I joined the Board of the Fund in 1962, 9 out of 16 Directors were dual, but in recent years only 3 Directors out of 22 in the Fund and 21 in the Bank have been dual. The United States never had a dual Director, although it had a dual Alternate Director for some years in the fifties. The decline in the practice of dual Directors does not result from any view that the need for coordination has diminished, but rather stems from the demand by countries for a presence at these institutions as the number of members has expanded and from the pressures of a greatly augmented work load at both institutions.

I am unable to discover that cooperation and collaboration between the two organizations became a hot topic or a major bone of contention between them in the first two decades--that is to say, in roughly the first half--of their history. The Bank lent for projects and the Fund for one-year stabilization programs that did not (consistent with the needs of the time) contain very much evidence of preoccupation with structural factors. Moreover, there was not as much consistent overlap of clientele of the two institutions as became the case in later years.

It was not until 1966 that collaboration became the subject of written arrangements. Memoranda of January 1966, presented to the two Executive Boards, covered the procedural aspects of cooperation. They confirmed the need for close and continuous contact between the two staffs at all levels, the exchange of

information and the avoidance of evaluations communicated to a country by one institution that are not acceptable to the other. These documents also dealt with collaboration in the field by staff of one organization joining a mission of the other or by concurrent missions, provided the country agreed.

Dual memoranda of December 1966 dealt more directly with substantive issues, in particular with the competence of each organization and the need for consistent views and consistent advice to countries. Paragraphs 4 and 5 of these dual (and identical) memoranda contained a set of statements agreed by the President of the World Bank and the Managing Director of the Fund describing the areas of primary responsibility of each of the two institutions. These statements, like the other memoranda on the subject, were approved by the two Executive Boards. Given the importance of these paragraphs, which remain the agreed statements on the subject, these are attached.

In 1970, as the two organizations steadily became more active in financial and advisory activity with more countries and thus the need for detailed collaboration became more pronounced, a joint memorandum of the Managing Director and the President of the Bank supplemented the procedures set out in January 1966. The intent of this memo was to foster closer collaboration in Washington before and after missions go into the field and to cover a number of administrative details on collaboration such as the systematic exchange of a growing and voluminous production of documents.

During the past decade and one half, the improvement and extension of collaboration between the Bretton Woods "twins" has been a normal and regular preoccupation of the two managements, staffs and Executive Boards. Intensification of the process became imperative as the economic problems of member countries grew deeper and took on a deeper structural element in response to the sea change in energy prices and the other sweeping shifts in economic conditions that these years have seen. Not only were the problems compelling, but the responses of the two institutions to them would have forced an augmented level of collaboration if the habits and arrangements had not already been in place. The joint establishment of the Development Committee, the Fund's adoption of the extended facility in 1974, the Bank's policy on structural adjustment lending adopted in 1980 and the intense work of both institutions on debt problems all through these years, but especially over the past three years, are only a few of the many initiatives and activities through which the work of the two organizations impinged on each other and called out for active collaboration. In some respects, the activities of the two through these and other policies have narrowed any remaining neutral ground around the border between them. The Fund has become much more deeply and operationally interested in investment and production and it often wants to look to the Bank for an evaluation and appraisal of a country's development program, especially where extended arrangements are concerned.

The Bank, always interested in stable economies and financial situations as a basis for sound growth, has in recent years intensified its interest in Fund appraisals of a country's macro-economic policies and in the willingness of the Fund to provide financial support through a suitable stand-by or extended arrangement. Both organizations have in recent years run up against financial constraints and have needed added financial support from the membership.

So far, the managements and staffs of the two organizations have approached mutual collaboration in a very positive spirit and in a pragmatic way. Wisely, I believe, they have always chosen informal and flexible means over institutionalization and rule-making. Whenever possible, collaboration at the working level has been emphasized over high level meetings or administrative machinery. I would suggest that this approach be followed for the future as well.

For the future, my inclination would be not to oversell the probable benefits of enhanced collaboration or to expect too much from it. Of course, I take the view that the Bretton Woods institutions must be expected to collaborate actively--perhaps even aggressively--as a matter of course and of routine.

It has to be kept in mind that each of these two international financial institutions -- though they are sometimes described as "twins" -- has over nearly 40 years of history evolved its own idiosyncratic history and approach. The organizations are very different in size, in approach to problems, in organizational arrangements, and in the rhythm with which they conduct financial negotiations and their other work. In consequence, it is very difficult on many occasions to collaborate effectively between the two but I believe collaboration has been effective and is effective.

But there is one thing that collaboration cannot reasonably be expected to do -- namely to produce a fully unified position between the Bank and the Fund at all times. If it is right, as I am certain it is, to have these two organizations with distinct terms of reference and personalities, then coordination will never achieve perfection. Nor should it.

At present, I would think the main issues of collaboration between the Bank and the Fund relate to countries in Latin America and Africa with serious debt situations. In Latin America, I think that the recent debt settlement with Chile, where World Bank financial arrangements played a critical role,

represent a new and welcome departure. In Africa, there has been a deterioration in economic performance that is extremely serious in many countries. The Bank and Fund, working separately and together, face a major challenge in that continent.

Attachment

The Primary Responsibilities
of
The World Bank
and the
International Monetary Fund ¹

"4. As between the two institutions, the Bank is recognized as having primary responsibility for the composition and appropriateness of development programs and project evaluation, including development priorities. On those matters, the Fund, and particularly the field missions of the Fund, should inform themselves of the established views and positions of the Bank and adopt those views as a working basis for their own work. This does not preclude discussions between the Bank and the Fund as to those matters, but it does mean that the Fund (and Fund missions) will not engage in a critical review of those matters with member countries unless it is done with the prior consent of the bank.

¹ "Paragraphs 4 and 5 from identical memoranda of December 1966 from the President of the World Bank and the Managing Director of the International Monetary Fund. These paragraphs were published in Joseph Gold's, "The Relationship between the International Monetary Fund and the World Bank," *Creighton Law Review*, Volume 15, 1981-1982, Number 2.

Attachment: Page Two

"5. As between the two institutions, the Fund is recognized as having primary responsibility for exchange rates and restrictive systems, for adjustment of temporary balance of payments disequilibria and for evaluating and assisting members to work out stabilization programs as a sound basis for economic advance. On these matters, the Bank, and particularly the field missions of the Bank, should inform themselves of the established views and positions of the Fund and adopt those views as a working basis for their own work. This does not preclude discussion between the Bank and the Fund as to those matters but it does mean that the Bank (and Bank missions) will not engage in a critical review of those matters with member countries unless it is done with the prior consent of the Fund."

Chairman LUNDINE. Thank you very much. Mr. Fried.

STATEMENT OF EDWARD R. FRIED, SENIOR FELLOW, BROOKINGS INSTITUTION AND FORMER U.S. EXECUTIVE DIRECTOR OF THE WORLD BANK

Mr. FRIED. Thank you, Mr. Chairman.

As you pointed out in your opening statement, Mr. Chairman, increasing cooperation between the World Bank and the Fund has become a necessity and a fact of life, not a matter of choice. This conclusion, I would like to emphasize, follows from the international economic disturbances of the decade 1973 to 1982, which reduced world economic growth by over a half and nearly tripled inflation and unemployment.

Among its other consequences was a residue of very great payment distortions and a massive foreign debt of which the most dangerous portion, of course, is that owed by the developing countries. The Bretton Woods institutions have clearly played an important role in helping the world to cope with these problems, and I am convinced that they will become even more critical over the future.

But in this process, the traditional distinction between the primary responsibilities of the Bank and the Fund have become blurred, and it is timely, therefore, that your committee should examine this relationship and its implications.

The responsibilities of the two organizations were never in watertight compartments. Until the shocks of the 1970's, however, the usual distinctions drawn between their activities and approach were more or less accurate. The Fund promoted adjustment to temporary balance of payments problems. Policy prescriptions empha-

sized macroeconomic measures to restrain demand fairly quickly. Financial assistance was repayable within a few years. The Bank, on the other hand, promoted long-term development. Policy advice focused on investment priorities and on microeconomic reforms to bring about greater efficiency in the use of resources. Loans were more for projects, disbursed slowly, and are repayable over 15 to 20 years.

As a result of the oil price increase, deep world recessions, and the collapse of commodity prices, however, the correction of payment imbalances requires much more in the way of structural change and will take more time. The Fund responded accordingly, providing new and somewhat longer term forms of financial assistance, for example, through its extended fund facility and becoming involved in some of the Bank's areas of concern, for example, investment priorities and prices.

For its part, the Bank found that in some hard-pressed countries, longer term development could not proceed until some order was restored to the balance of payments. Consequently, it moved heavily into "structural adjustment lending"—a quick disbursing loan designed to improve the domestic policy environment for investment and development.

Thus, the area of overlapping activity between the Bank and the Fund grew larger and the necessity for close cooperation more urgent. What issues does this raise, and what, if anything, need be done about it?

First, one should ask whether this is a helpful or unhelpful development. Does it involve wasteful duplication or risk inconsistent policy advice? I would argue it has been helpful as well as necessary. Each institution has areas of special competence and expertise and has specialized forms of financial assistance. All of these assets will have to be brought to bear on the adjustment problem.

A danger exists that each institution will pursue its primary objective so assiduously as to work at cross purposes with the other. Thus, the Fund in designing stabilization programs may tend to pay inadequate attention to development policies. Or the Bank, in concentrating on development, will encourage policies that work against demand management. To avoid this, the two institutions will increasingly have to work out coherent programs that support growth as well as stability.

A second issue, and to my mind a minor one, is whether the staffs of the two institutions can work effectively together. In general, this is a technical matter that tends to be overrated in discussions of Bank-Fund cooperation. This is not to say that working difficulties do not arise or that rivalry over turf does not exist or that the flow of information is timely and complete, or that policy differences are quickly resolved. This would be too much to expect from two large, independent bureaucracies with somewhat different primary objectives.

Nor can differences in style be disregarded. The Fund traditionally has sought answers fairly quickly to short-term problems—that is its experience and practice—while the Bank's approach emphasizes longer term analysis. When one staff calls on the other for assistance, therefore, such differences in style can be a problem. With all this, changes in requirements are, by all accounts, bring-

ing about the necessary changes in procedures. As Mr. Dale just pointed out, collaboration has taken place on a regular basis. Each participates in the other's meetings. This is no less than is to be expected of responsible management. I don't think this is a focus of problems or issues.

A third issue concerns the adequacy of resources. Do the institutions have the financial capacity to promote durable recovery programs and the resumption of private capital flows to the developing world? Here I believe the immediate concern centers on the Bank. Since the emergence of the debt crisis in 1982, the Fund, properly, assumed the primary role, with the Bank in a supporting position.

Over the future, the Bank may have to step up its lending to promote growth as part of a collaborative adjustment program with the Fund. Requirements are essentially unknowable because they will depend on the effectiveness of domestic policies adopted by the borrowing countries and on external developments. But if stabilization in any country proceeds well, the Bank should be prepared to encourage the growth phase of an effective adjustment program. For the Bank to be in this position will require an increase in its capital—an issue that will be coming up for initial discussion at the Bank-Fund annual meeting in September.

A fourth question concerns new initiatives in Bank-Fund collaboration. Where the Fund has a stabilization program and the Bank a structural adjustment loan, the case for collaboration is particularly strong. In general, such collaboration takes place. It might be strengthened further in such cases if the two loans were negotiated jointly with the country concerned. Such a procedure could increase complications by widening the scope of negotiations. By the same token, it could also facilitate matters by demonstrating to the borrowing country that growth as well as stability was a concern of the adjustment program.

It is also worth emphasizing that the complementarity of the current efforts of the two institutions in the developing world should not obscure their distinctiveness. In relation to the debt problem, the Fund remains an institution primarily devoted to promoting stability; it is not an aid organization. The Bank remains the world's principal development institution, whose efforts to promote the efficiency of resource use contributes to a durable balance of payments adjustment.

Finally, you have also asked in your letter of invitation whether the Bretton Woods institutions "can and should play the lead role in addressing the threat to development and international financial stability brought about by the continuing debt crisis?" Taken literally, the most important factor in avoiding this threat will be the economic performance of the industrial countries.

This aside, my answer is that the Bretton Woods institutions surely have demonstrated their ability to carry out this function over the past few years. Had they not been in existence, coordinating the efforts and resources of the debtor countries, the commercial banks and the governments of the industrial countries would have been far more difficult, and the costs to the world economy in terms of output and employment would have been considerably

larger than it was. I believe these institutions will have to continue to play this role for some years to come.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Fried follows:]

Statement of Edward R. Fried *
Senior Fellow, The Brookings Institution

Before the Subcommittee on International Development
Institutions & Finance, Committee on Banking, Finance
and Urban Affairs of the House of Representatives

July 25, 1985

Cooperation Between the World Bank and the IMF

Increasing cooperation between the World Bank and the IMF has become a necessity and a fact of life, not a matter of choice. This conclusion follows from the international economic disturbances of the decade 1973-82, which reduced world economic growth by one-half and nearly tripled inflation and unemployment. Among other consequences, this abnormally poor performance left as its residue unprecedented payment distortions and a massive foreign debt, of which the most dangerous portion is that owed by developing countries. The Bretton Woods institutions (among which for convenience, and at the expense of accuracy, I include the regional development banks) have played an important role in helping the world to cope with these problems--a role that I believe will become even more critical over the future. In the process, the traditional distinction between the primary responsibilities of the Bank and the Fund has become blurred. It is timely, therefore, for your Committee to examine this relationship and to explore its implications.

The responsibilities of the two organizations were never in watertight compartments. Until the shocks of the 1970s, however, the

* The views expressed in this statement are the sole responsibility of the author and do not purport to represent those of the Brookings Institution, its Officers, Trustees, or other staff members.

usual distinctions drawn between their activities and approach were more or less accurate. The Fund promoted adjustment to temporary balance of payments problems. Policy prescriptions emphasized macro-economic measures to restrain demand fairly quickly. Financial assistance was repayable within a few years. The Bank, on the other hand, promoted long term development. Policy advice focused on investment priorities and on micro-economic reforms to bring about greater efficiency in the use of resources. Loans were mostly for projects, disburse slowly, and are repayable over fifteen to twenty years. (50 years in the case of IDA credits for the poorest countries.)

As a result of the oil price increases, deep world recessions, and the collapse of commodity prices, however, the correction of payment imbalances requires much more in the way of structural change and will take more time. The Fund responded accordingly, providing new and somewhat longer-term forms of financial assistance, for example through its Extended Fund Facility and becoming involved in some of the Bank's area of concern, for example, investment priorities and prices. For its part, the Bank found that in some hard pressed countries, longer term development could not proceed until some order was restored to the balance of payments. Consequently, it moved heavily into "structural adjustment lending" - a quick disbursing loan designed to improve the domestic policy environment for investment and development.

Thus the area of overlapping activity between the Bank and the Fund grew larger and the necessity for close cooperation more

urgent. What issues does this raise and what if anything need be done about it?

First, one should ask whether this is a helpful or unhelpful development. Does it involve wasteful duplication or risk inconsistent policy advice? I would argue it has been helpful as well as necessary. Each institution has areas of special competence and expertise and has specialized forms of financial assistance. All of these assets will have to be brought to bear on the adjustment problem. A danger exists that each institution will pursue its primary objective so assiduously as to work at cross purposes with the other. Thus the Fund in designing stabilization programs may tend to pay inadequate attention to development policies. Or the Bank, in concentrating on development, will encourage policies that work against demand management. To avoid this, the two institutions will increasingly have to work out coherent programs that support growth as well as stability.

A second issue is whether the staffs of the two institutions can work effectively together. In general, this is a technical matter that tends to be overrated in discussions of Bank-Fund cooperation. This is not to say that working difficulties do not arise, or that rivalry over turf does not exist, or that the flow of information is timely and complete, or that policy differences are quickly resolved. This would be too much to expect from two large, independent bureaucracies with somewhat different primary objectives. Nor can differences in style be disregarded. The Fund

traditionally has sought answers fairly quickly to short term problems, while the Bank's approach emphasizes longer-term analysis. When one staff calls on the other for assistance, therefore, such differences in style can be a problem. With all this, changes in requirements are, by all accounts, bringing about the necessary changes in procedures. This is no less than is to be expected of responsible management.

A third issue concerns the adequacy of resources. Do the institutions have the financial capacity to promote durable recovery programs and the resumption of private capital flows to the developing world? Here, I believe the immediate concern centers on the Bank. Since the emergence of the debt crisis in 1982, the Fund, properly, assumed the primary role, with the Bank in a supporting position. Over the future, the Bank may have to step up its lending to promote growth as part of a collaborative adjustment program with the Fund. Requirements are essentially unknowable because they will depend on the effectiveness of domestic policies adopted by the borrowing countries and on external developments. But if stabilization proceeds well, the Bank should be prepared to encourage the growth phase of an effective adjustment program. For the Bank to be in this position will require an increase in its capital--an issue that will be coming up for initial discussion at the Bank-Fund annual meeting in September.

A fourth question concerns new initiatives in Bank-Fund collaboration. Where the Fund has a stabilization program and the Bank a structural adjustment loan, the case for collaboration is

particularly strong. In general such collaboration takes place. It might be strengthened further in such cases if the two loans were negotiated jointly with the country concerned. Such a procedure could increase complications by widening the scope of negotiations. By the same token, it could also facilitate matters by demonstrating to the borrowing country that growth as well as stability was a concern of the adjustment program.

It is also worth emphasizing that the complementarity of the current efforts of the two institutions in the developing world should not obscure their distinctiveness. In relation to the debt problem, the Fund remains an institution primarily devoted to promoting stability; it is not an aid organization. The Bank remains the world's principal development institution, whose efforts to promote the efficiency of resource use contributes to a durable balance of payments adjustment.

Finally, you have also asked in your letter of invitation whether the Bretton Woods institutions "can and should play the lead role in addressing the threat to development and international financial stability brought about by the continuing debt crisis?" Taken literally, the most important factor in avoiding this threat will be the economic performance of the industrial countries. This aside, my answer is that the Bretton Woods institutions surely have demonstrated their ability to carry out this function over the past few years. Had they not been in existence, coordinating the efforts

and resources of the debtor countries, the commercial banks and the governments of the industrial countries would have been far more difficult, and the costs to the world economy in terms of output and employment would have been considerably larger, than it was. I believe these institutions will have to continue to play this role for some years to come.

Chairman LUNDINE. Thank you very much. Mr. Phaup.

STATEMENT OF E. DWIGHT PHAUP, CHAIRMAN, ECONOMICS DEPARTMENT, UNION COLLEGE, SCHENECTADY, NY; AND ALSO HERITAGE FOUNDATION CONSULTANT AND WRITER

Mr. PHAUP. Mr. Chairman, in my prepared testimony I attempt to treat two questions that have been associated with calls for increased Fund Bank cooperation. First, do the policies upon which the IMF conditions its loans represent a barrier or impediment to the growth aspirations of the countries concerned? Second, would the cost of adjustment be significantly lowered if the IMF extended the term of its loans?

These questions are related to the subject of these hearings in that some of those who recommend greater cooperation between the Bank and Fund see such cooperation as a step toward having the Fund temper the austerity of its recommendations and take a more lenient attitude toward LDC's and their need to adjust to their external imbalances. At this time I would simply like to provide very brief summaries of the answers I propose to these two questions:

Do IMF policies retard economic growth?

The evidence suggests that the answer is clearly no. As you know, the Fund frequently requires loan recipients to adopt more competitive exchange rates or exchange rates more consistent with the Nation's currency's purchasing power. It also requires lower, noninflationary rates of growth in monetary and credit aggregates, reduced use of subsidies and price controls, and restrained levels of government spending. These are precisely the types of policies that I and others have found to be associated with relatively rapid rates of growth among developing countries.

The idea behind adjustment to external imbalance is not that an economy must be denied a healthy growth rate. Indeed, adjustment is assisted by sustainably high growth rates. It is in fact by more than fortuitous accident that the policies which lead to sustainable growth and policies which are necessary for adjustment to external imbalances are essentially the same.

It should in fact appeal to our intuition that what serves economic growth would also serve economic balance. But what of the time horizon used by the Fund? Should we attempt to spread the cost or burdens of adjustment over a longer time period than the Fund seems currently willing to allow?

Again, the record indicates that the answer is no. There are several reasons for this response. First, a credible and determined adjustment plan by indebted LDC's need not and indeed should not result in heavy adjustment costs. We know that where governments have adopted policies which are believably workable that the adjustment costs have been held to modest levels. Thus, well-conceived and aggressively executed adjustment policies typically don't require a prolonged adjustment period.

Second, for an adjustment program to work, to change incentives and behavior, the signals that the economic agents receive must also change. Delaying the period of adjustment and thereby muffling the signals that those agents will see will merely delay the adjustment and any associated costs. It will not eliminate or reduce those costs.

Finally, the record is especially dramatic in indicating that the extension of the adjustment period is rarely used to engineer a soft landing. International monetary experience is riddled with case histories in which breathing spells were used to delay or postpone the adoption of meaningful adjustment policies. There is no reason to expect the countries under review to behave any differently.

In short, appreciably altering the stance of the IMF in the adjustment process is not necessary. The Fund's requirements do not conflict with the goal of sustained economic growth in developing countries and an extension of the term of maturity of the Fund loans would likely be seen as a weakening of the resolve of LDC's and the Fund to adopt workable adjustment programs, would yield a less effective adjustment program overall and would likely result in adjustment delays which would lead to more intense crises later on.

IMF policies in its case by case approach, in dealing with LDC debt problems, have so far been effective, probably much more so than most observers only a few months ago would have thought. In my opinion, there is no compelling reason to interfere with the approach that is being taken.

Thank you.

[The prepared statement of Mr. Phaup follows:]

Adjustment and Development:
IMF-World Bank Cooperation and Coordination

Testimony Prepared for
Joint Hearings of the
Subcommittees on International Finance, Trade and Monetary Policy
and on International Development Institutions
of the House Committee on Banking, Finance and Urban Affairs

by

Dwight Phaup
Professor of Economics
Union College
Schenectady, NY 12308

July 25, 1985

Adjustment and Development:
IMF-World Bank Cooperation

Introduction. As the intensity of the international debt crisis has subsided--in part because of the policy measures urged on some indebted LDCs by the IMF--calls for increased cooperation and coordination between the IMF and its sister institution, the World Bank, have been made. The idea of increased cooperation, however, apparently means different things to different people.

On one level, increased cooperation simply suggests what we might term "bureaucratic fine-tuning," where the two agencies improve measures to exchange information on the countries they both follow and on pending agency action; to implement joint cost-savings programs; to engage in joint research; and so forth. It is difficult to argue with proposals of this sort and specific suggestions for such improvements from those who work or have worked within the Fund and Bank would be welcomed.

At another level, "increased Bank-Fund cooperation" translates into having one or both of the agencies shift policy direction or attitudes toward those perceived to characterize the other. Some bank critics ("conservatives" to many) have long thought that the Bank is not sufficiently demanding of its borrowers -- that it at least tolerates and perhaps encourages far too much central planning and statism; certainly, they argue, it gives too little attention to the potential for growth that

can be unleashed by policies that encourage private initiative and markets. Thus, with its emphasis on market forces, export-oriented growth, reduced government spending, more realistic exchange rates, tighter monetary policy and the like, the IMF should serve as a role model to the Bank from the perspective of the latter's critics.

Similarly, those who might be associated (rightly or wrongly) with "the Bank philosophy" (the liberals) may well see the tough adjustment policies of the Fund as too drastic or insufficiently sensitive to the problems of LDCs -- their domestic political situations and their "need to grow." They would prefer the Fund to "loosen-up" and provide longer term, larger and less stringent adjustment loans; to be, in short, more like the Bank in its attitudes towards LDCs.

In a variant of the above version of "cooperation," the Bank and Fund are to move to some middle ground with the Fund emphasizing longer-term adjustment loans and the Bank continuing to shift away from project-specific to more general, structural adjustment loans. The hope here is to have adjustment and debt repayment without sacrificing growth or development rates. In an extreme interpretation, cooperation by the Bank and the Fund could also result in some new agency specifically designed to deal with debt problems of the LDCs.

This testimony concentrates on whether the Fund should alter its policies in light of their effect on the growth prospects of LDCs and on whether establishing a program which essentially excuses some or all of the debt obligations of LDCs is desirable.

Its main conclusions are that 1) there is no fundamental conflict between adjustment-oriented and development-oriented policies, 2) there are no longer-term advantages from delaying the adoption of (even stringent) adjustment policies, and 3) a new debt-relief agency or debt-relief program within the Bank and/or Fund is neither necessary nor desirable.

Adjustment vs. Development. At least implicit in some of the discussion about the need for Bank-Fund cooperation and coordination is the notion that the policies that the Fund has insisted on as conditions for adjustment loans are inimicable to or inconsistent with policies that promote growth. Some have consequently called for adjustment policies (which include debt repayment) but only if they do not "hurt the growth prospects of the countries concerned."

As a literal or absolute policy goal, such statements cannot be taken seriously. Relative to a situation in which outstanding debt is not repaid, repayment in and of itself will temper growth prospects; after all, the repaid principle and interest could always have been otherwise used in some manner to improve the growth rate. Similarly, the notion of painless adjustment (to debt repayment requirements and balance-of-payments disequilibrium) is not realistic. The costs of adjustment may be postponed or occasionally even spread over time, but they cannot be avoided. Any sort of adjustment which recognizes changes in relative supply or demand conditions will impose costs on some group.

In a policy sense, however, there need be no conflict

between balance-of-payments adjustment (and debt servicing) on the one hand and economic development on the other. Except perhaps in the very short run, the policies the IMF recommends to foster adjustment are essentially the same as those associated with faster growth rates in the LDCs. Specifically, the IMF has tended to recommend a set of policies which include exchange rates consistent with relative purchasing power, non-inflationary rates of growth in monetary and credit aggregates, greater emphasis on production for export markets, reduced levels of government expenditure (especially for interest subsidies), and, in general, greater reliance on market mechanisms for reflecting relative scarcities and allocating resources.

These are essentially the same policies which have been found to be associated with high growth rates in LDCs. Examining data for the fourteen fastest-growing non-oil exporting LDCs during the 1970's and early 1980's, and for the eighteen slowest growing developing nations reveals that the latter group maintained exchange rates which (relative to their purchasing power equivalents) were overvalued by almost 27 percent for the rapid growers, the comparable figure was a relatively modest three percent.¹ Overvalued domestic currencies (exchange rates) cause imports to be artificially cheap and decrease the competitiveness of a nation's exports; essentially, they subsidize consumption of foreign goods and tax exports. For both growth and adjustment, therefore, realistic exchange rates are appropriate. Similarly, rapid and volatile rates of monetary expansion and price inflation slow growth and hamper adjustment

by discouraging capital accumulation, reducing international competitiveness, increasing uncertainty, and redirecting resources from productive uses to inflation hedges. Unsurprisingly, then, slow-growing LDCs had monetary growth rates 50 percent higher than the fast growers, inflation rates more than double the rate of the fast growers and money supply variability twice that of their high growth counterparts. Again, monetary restraint makes sense not only for adjustment but also for growth. The story is much the same in other policy areas: slow-growing nations had significantly greater or more obtrusive price distortions through controls, subsidies and the like than did fast growers; they also had significantly higher trade barriers, lower exports, higher ratios of public consumption to GNP, etc. The presumed austerity programs of the Fund, in short, converge to an impressive degree on precisely the same package of programs which have been found to promote economic development and growth.² Consequently, there is no real conflict between growth policies and adjustment policies, and to the extent that the Bank and the Fund are committed to those respective goals, there should be little if any conflict between their policies or the conditions they might attach to the loans they provide. Good economic policy in the longer run is good economic policy regardless of whether one refers to growth or to adjustment -- a comforting finding.

Still, disagreement might emerge over how rapid the conversion from "bad" policy to "good" policy should be. Specifically, the presumably longer-term time horizon of the Bank

is often recommended as also appropriate for the Fund whose policies are regarded by some as too much of a "shock treatment." Longer adjustment periods ostensibly lower or at least spread out adjustment costs and are less likely to jeopardize growth rates. For example, sharp relative price changes brought on by reduced subsidies obviously impose costs on those who enjoyed the benefits of the subsidy. Or, changes in the stance of monetary policy to a less inflationary level will impose costs on those who had bet on continuing inflation. A dramatic alteration in the exchange rate may drive up import prices well before it stimulates foreign demand for domestic goods and thereby impose costs. Those who recommend slower adjustment rates believe that these costs can be attenuated overall or per unit time. Adjustment costs could conceivably be reduced through the judicious application of spending measures whereby, say, government spending is lowered only as foreign spending increases. In this way, employment levels can be maintained. Or, adverse political reaction to reduced subsidies could be diffused if the subsidies were eliminated gradually, according to the argument.

Unfortunately, there are a number of reasons for believing that a gradual adjustment process will fail to deliver what its advocates promise. First, the notion that governments can so finely tune an economy as to have government or other spending respond in just the right amount and at just the right time to previously induced changes in external demand is hard to believe. It suggests a level of control and discipline, flexibility, and

knowledge of economic conditions, and lag lengths that have never been observed beyond the classroom blackboard. If economies could be controlled so neatly, it is hard to understand why they ever dysfunction.

The elimination of subsidies generates political unrest among some groups because without the subsidy their real incomes are lower. The question is, how long does the adjustment period or how slow does the adjustment process have to become before the affected groups are unaware that their real incomes have been lowered? In the absence of extremely high discount rates, those groups will realize that the present values of their discounted future income flows are lower as soon as the adjustment plan is announced. Simply because the change does not occur all at once does not prevent individuals from making an appropriate re-evaluation of the present value of their real future incomes, nor does it prevent them from responding accordingly. Spreading out the adjustment period serves only to give hope that the government is not seriously committed to the adjustment or that more time will be available to dissuade the government from completing the adjustment. There is certainly no reason to expect that a slowed adjustment process will somehow camouflage the distributional effects it must generate for the adjustment to be successful. Further, there is no assurance that those adversely affected by adjustment will use any extra time to cushion themselves from it; the disappointments of U.S. trade adjustment assistance may fit this mold.

Furthermore, adjustment to new economic conditions occur as

those new conditions are reflected in relative price changes; indeed it is a reaction to the price changes that constitutes the adjustment. If price changes are muffled by controls and subsidies designed to spread out the adjustment period, the adjustments may not occur at all. Individuals will respond only to price changes which actually occur and not to changes which would have occurred in the absence of controls. Thus, for example, the total impact over a four year period of, say, a 10 percent devaluation today is likely to be much greater than the impact of four 2.5 percent devaluation spaces evenly over the same four year period.

Moreover, sudden adjustments need not imply high dislocation costs. Some, for example, would argue that counter-inflationary monetary policy generates unacceptably intense and growth-retarding recessions. We know, however, that the real effects of monetary policy changes depend heavily on whether economic agents have their expectations altered by the policy shift. If a policy change is credible and widely regarded as a determined and prolonged attempt to control inflation, a reduction in monetary growth rates may have very few real effects. The sharp restructuring of money policy which terminated the post World War I German hyperinflation -- which was far worse than any inflation observed today -- serves as an instructive case-in-point.³ The lesson here is that extending an adjustment period or other attempts to make it "painless" may be counter-productive to the extent that such efforts are interpreted as evidence of uncertain commitment to the

adjustment or, equivalently, an unwillingness to pay the price of adjustment.

Finally, the historical record does not speak favorably to the idea that the additional time gained through obtaining funds to finance payments of deficits will in fact be used to work out an adjustment program. Consider, for example, the lessons of the adjustable peg period during the 25 years following the Second World War. Under that system, countries had two options -- just as today -- to adjust to payment imbalances: exchange rate changes and aggregate demand policies. Recognizing that some imbalances were temporary and self-correcting and realizing that some nations had insufficient reserves to finance a deficit before corrective policies began to have an effect, the system allowed for borrowing from the Fund on a temporary basis. Limitations on reserves -- both owned and borrowed -- were supposed to serve a disciplining role to force nations to adopt one of the available adjustment strategies. For reasons very similar to those we hear today, however, nations wanted to excuse themselves from adopting effective adjustment policies: devaluation would be inflationary and interpreted as a sign of economic weakness while contractionary aggregate demand policies would be too costly in terms of domestic employment.⁴ Increasingly, nations argued that their payment imbalances were only temporary and hence additional financing was all that was required. Some charged that they simply needed more time to adjust -- that financing was required while relatively painless structural adjustments were made that would resolve the imbalance

without the need for uncomfortable aggregate demand or exchange rate changes. As we now know, the imbalances turned out to be much more than temporary and the structural adjustments were seldom forthcoming. The system came to be characterized as involving "adjustment by crisis" when adjustment came at all. Indeed, the failure to adjust promptly and decisively to payment imbalances is widely regarded as the fundamental cause of the breakdown of the former Bretton Woods system.

The lessons of this period are clear: even the Western developed nations which were suppose to exercise leadership in the international financial arena did not use additional borrowed or created reserves or other pallitives to effect a viable and lasting adjustment program. Rather, they used them to postpone adjustments until a state of crisis provided them no alternative. There is, in my reading of the record, no reason to expect that other nations will behave any differently.

To summarize, growth policies and adjustment policies do not involve any fundamental conflicts. The purpose of adjustment is not to reduce output or growth rates. To the contrary, faster growth can help insure easier adjustment. Adjustment is simply designed to alter the disposition of that output and to insure that consumption and investment rates do not exceed sustainable levels. Hence, the policy advice and terms of conditionality offered by the Bank and the Fund should converge regardless of whether there is additional or explicit coordination of policy. That is, increased coordination in one sense should not be necessary since the policy advice coming from each institution

should be the same.

Further, in my opinion, the case for maintaining the Fund's "monetary" nature -- for having it encourage prompt and decisive policy changes to achieve adjustment -- is persuasive. Its approach has so far been effective. Moreover, allocating the additional resources to the Fund necessary for it to significantly extend adjustment periods would not only be expensive but, based on past experiences, would probably only result in the indefinite postponement of meaningful adjustment policies.

Further Considerations Regarding the Debt Problem. This section comments briefly on proposals to appreciably reduce the debt obligations of LDCs through increased World Bank loans to the especially indebted or through the creation of some new agency to purchase LDC loans.

- 1.) A program of providing additional resource transfers to those nations which are the most heavily indebted and which have failed to adopt the policies necessary to correct their payments imbalances generates an extremely perverse set of incentives for LDCs. Nations which have adjusted to structural changes in the world economy would justifiably feel swindled if subsequent to that adjustment, other governments were excused from their responsibilities. No nation could reasonably expect to make the necessary sacrifices in the future to correct excesses or react to new conditions.
- 2.) The transferring of resources to indebted nations in roughly the same proportion as their share of total debt would grossly

violate the principle that resource transfers should be based on relative per capita income or "need" in the usual sense of the term. The heaviest borrowers are among the most developed and economically advanced of the LDCs. Debt relief therefore for such nations would be perverse on distributional as well as incentive grounds.

3.) Any scheme to reduce the debt burden on LDCs would obviously be very expensive. Recommendations that some international agency assume the loans of the developing nations are typically ominously silent on the matter of funding. In any event, given current budgetary pressures in the U.S., proposals for new expensive international agencies should receive a cool reception at best.

Conclusion. The policies being recommended by the IMF to effect adjustments in LDCs with debt-servicing problems have been working well, although not costlessly for all concerned. As in other areas, however, breaking bad policy habits often involves short run withdrawal pains. Trying to delay or extend the adjustment period serves only to delay or extend the point at which the benefits of appropriate policies begin to emerge; it also may cause correctives to be rejected under the hope that adjustment can be attained at no or low cost. Institutionalizing the extension of payments adjustments, therefore, is not desirable. Even less desirable is the introduction of some inevitably expensive new program which rewards those nations which fail to adjust.

FOOTNOTES

1. See Dwight Phaup and Brad Lewis, "Winners and Losers: Differentiating Between High-Growth and Low-Growth LDCs," in Doug Bandow (ed.), U.S. Aid to the Developing World, Washington D.C.: The Heritage Foundation, 1985.
2. In addition to the study cited above, see the World Bank, World Development Report 1981, Washington D.C., 1981; Lloyd G. Reynolds. "The Spread of Economic Growth to the Third World, 1890-1980," Journal of Economic Literature 21 (September 1981) and other studies cited in Phaup and Lewis.
3. Thomas M. Humphrey, "Eliminating Runaway Inflation: Lessons from the German Hyperinflation," Federal Reserve Bank of Richmond, Economic Review 66 (July/August 1980).
4. Dwight Phaup, The Discipline Argument for Fixed Exchange Rates, Unpublished Ph.D. Dissertation, University of Virginia, 1974.

Chairman LUNDINE. I thank you for your brevity and being straight to the point, as well as for your testimony. I am going to call on Mr. Neal to question first and also turn the mythical gavel over to him briefly.

Chairman NEAL [presiding]. Thank you, Mr. Chairman. Recently Henry Kissinger said, and I quote:

The international financial institutions * * * have gone to the limit of * * * what the charter of international organizations will permit," and that consequently, "the United States must now propose the modern philosophical equivalent of the Marshall plan".

As I read that, he is saying that the IMF and World Bank aren't up to the task even with better coordination, and that we need some kind of third new institution to deal with this problem in its current magnitude. What do you think of that comment?

Mr. BRADFORD. If I might respond first, I think, Chairman Neal, what he seems to be implying—and I think Helmut Schmidt argued along the same lines—having talked to Kissinger about it, it seems he is arguing in favor of a U.S. program rather than a new economic institution. Is that correct?

Chairman NEAL. I don't know.

Mr. BRADFORD. What strikes me—and it requires a little more study—is whether or not—Mr. Fried I think perhaps has a better view of this—whether or not the resource flow through the Fund and the Bank is adequate. One of the reasons that I could see this shorter term approach being taken in the fund, for example, is because the resource flow is not adequate for a more medium term outlook.

I haven't studied the numbers enough to be clear about whether it is a policy constraint that is at work or whether it is a resource constraint at work in the case of the Fund. I do know, and I know you know, that the Bank needs more support in terms of resource flows. So I can believe and argue for more resource flows.

I am not so open to a positive response to the idea of a new international institution. I am not convinced at the outset that that is the requirement.

Chairman NEAL. What you are saying then, is that the IMF-World Bank, with adequate funding and support, are up to the task. That is the basic question.

Mr. BRADFORD. It certainly seems to me, yes, indeed.

Mr. FRIED. I agree with that, Mr. Chairman.

I see no reason to establish a new international institution for this purpose. I think the machinery we have in place is effective. I think it would be ironic to think about replacing it with something else when it has demonstrated its capacity to do the job if it has the resources to do so.

Chairman NEAL. I think he is implying maybe beyond what is in place that we need something like a Marshall plan.

Mr. FRIED. I am sorry, I am not familiar with the statement, and I take it that you are quoting what seems to be the big headline. Whether or not current flows are adequate or will be adequate over the future is of course a real question. It is going to depend, in my view, essentially on what kind of external environment exists—on whether we have low growth, medium growth or high growth in the industrial countries? That is going to be key.

I think we can take it pretty much for granted that the shocks of the past few years will leave the commercial banks out of the picture as sources of net flows for some time to come. This is a danger that the international community, at the least, has a responsibility to examine.

Mr. PHAUP. If I could just make a couple of comments. To the extent that some sort of new agency would be providing aid, especially to those countries which are already most indebted, and to the extent most of those countries already most indebted have failed to adopt adjustment policies, I see an institution like this as having certain perverse effects, which I mentioned in my testimony. But to repeat them:

First of all, it tends to validate a nation's failure to respond to its external problems. There are some countries clearly which have already adopted stringent adjustment policies and they probably would receive fewer resource flows from such institutions than those countries that have been less responsible in their response to their conditions. I think to validate that failure to adjust by giving those countries which behave less responsibly additional flows establishes poor signals to other developing countries.

Second, it is not at all clear those countries which have the largest debt problems are also say, the poorest countries on a per capital income basis. To the extent we would like to see resource flows go toward in some sense what has traditionally been regarded as the neediest countries, a program like this would offend that principle.

Finally, I suspect a program like this is going to be costly. I wonder what the Secretary's recommendations were for financing something like this?

Chairman NEAL. He didn't have any. Anyone else?

Mr. DALE. I had better complete the round, Chairman Neal.

I agree a new institution is not necessary and could conceivably be harmful or perverse. If the idea of a Marshall plan were to be that somehow considerably enlarged amounts of bilateral resources would flow alongside and in connection with the Bank and the Fund, that would be fine, because I think the issue is the volume of resources available to do the job, which is a pretty large one and remains a large one.

The issue of how to finance that and the willingness of legislatures, including this one, to finance it would be the big question. I had some experience when I was with the Fund in trying to organize official assistance alongside Fund assistance and Bank assistance, and I can tell you it is a very tough job, even in countries where one would suppose it would be like falling off a log.

Chairman NEAL. I think Stan and I both can tell you it isn't easy around here either. Just my own observation of this over time, I think it is rather important—I believe you are saying the same thing—that we keep the roles of the two organizations clear and separate. Although it certainly seems desirable for there to be a better cooperation and, coordination, especially in terms of maybe targeting those countries that need adjustment, balance-of-payments assistance, and long-term development assistance, we should not change their essential roles.

I think certainly, not only from the point of view of being useful and helpful in the world economy, as Dr. Phaup has pointed out, but also just in terms of the realities, political realities of getting support from legislatures for the funds. We have a heck of a time getting adequate funding for these organizations.

Does anyone agree with that?

Chairman NEAL. Do I have time for one more?

Chairman LUNDINE [presiding]. Certainly.

Mr. Bereuter.

Mr. BEREUTER. Thank you.

I was thinking about that analogy Professor Bradford used. It seems like we have two IMF's now and it really hasn't increased cooperation too much to the casual observer, to the insider either.

Dr. Fried, in your paper you suggest that the Bank may have to step up its lending to promote growth, and you talk about the need for additional funding, increasing capital. Beyond the increase in capital, are there other ways that you could suggest it step up its effort to promote growth?

Mr. FRIED. The Bank now, Mr. Bereuter, emphasizes in its loans, in its structural adjustment loans in particular, a wide range of economic policy reforms which it believes are essential for countries in trouble to take in order for them to regain stability and promote growth. I am convinced that the Bank should be in the position over the future to be able to move in where it has been shown that such countries have taken the necessary actions and are prepared to use resources or are using resources more efficiently, and would be able to use additional external loans effectively.

I believe very strongly that the restoration of a higher growth path in the developing world is one of key importance to all of us. This will depend in the first instance on effective policies in these countries. It will also depend in part on expanding Bank role in these countries. So the two things have to go together. Where affairs are moving right, the Bank should be in position—that is, have the financial capacity—to push them along further.

Mr. BEREUTER. Dr. Dale speaks positively about the recent economic package put together for Chile—of course involving the World Bank loans—as a vital element in assuring the continuing lending from commercial banks and the IMF. I wonder if any of you think this is a model more likely to be seen in the future? Is it desirable? Does anybody care to vent an opinion?

Mr. FRIED. I am not familiar with this particular case.

Mr. DALE. I cited it in testimony precisely because I think it is desirable and may be helpful in other cases. I wouldn't want to say it would be universally helpful necessarily, but the way in which it worked, as I understand it, is that the Bank did two things which have not been done in the rescheduling packages before. In particular, the new money portion of the rescheduling package.

The Bank put up itself a program loan, and initially the bank provided, I think it was \$150 million of guarantee authority, which is very unusual because the bank, while it has the guarantee authority, has made very sparse use of it over the years. But I understand not only from officials but from commercial banks who were engaged in the process of the Chilean negotiations, that without those two elements in the package it would have been extremely

difficult, and perhaps impossible, to put together the new money portion of the package which itself was critical in those negotiations.

Mr. BEREUTER. We have heard that same conclusion in a previous hearing.

Dr. Phaup summarizes the primary thrust of his paper as follows:

"Growth policies and adjustment policies do not involve any fundamental conflict." That is a matter of fairly intense and continuing debate here on Capitol Hill, and I wondered if anyone would like to express any caveats or reservations or outright disagreement with the conclusion of his paper?

Mr. BRADFORD. Yes. I was a little concerned when Chairman Neal mentioned there were no differences of view about relative roles because I think between Dr. Phaup and myself at least, there is a fundamental divergence in terms of whether the short term assistance which the Fund makes available for adjustment purposes is indeed compatible with the growth in the real side of the economy, the employment output side of the economy, in the medium term.

I suggest that there is a dichotomy here and I think one of the reasons that there is is because of the way in which the idea of successful adjustment policies is conceptualized. Again, it comes from the East Asian cases and I didn't go into this side of it in my earlier remarks, so let me for a minute spell out how, as opposed to the development side, how the stabilization or adjustment side of the story might be told, and why it is I think Dr. Phaup reaches the conclusion he does and why I reach the one I do.

I think basically that what I refer to as the stereotyped or stylized version sees countries moving from inward oriented import substitution, interventionist policies in the past and making decisive shifts at a moment in time to outward oriented export promotion and market mechanism policies in one fell swoop.

So what you do is you devalue the exchange rate, you reduce import controls, you try to draw back Government subsidies and cut the fiscal deficit, which is fine, but you try to reduce the direct role of Government in the economy, and essentially try to put in one step the economy on a different footing, and it is this idea of adjustment which is seen as being the successful development step for the East Asian success story.

So the way in which Dr. Phaup would arrive at the conclusion there is no tradeoff between short- and long-run requirements is that the policies that are necessary to achieve adjustment payoff in terms of future growth is through the efficient resource allocation that is seen to result immediately from this once and for all conversion from interventionist policies of the past to market-oriented policies.

It just seems to me frankly, that this isn't the way it has worked in the successful cases, as I said, and that it is not likely to be a feasible path for countries dealing with the kinds of pressures they are dealing with. In fact, I see, because of the long-term requirements of exporting in order to pay off the long-term debt in the major countries, such as Korea, for example, as well as the Latin American, East European, and Southern European countries, is

that there is a much more--there is, first all all, a fusion of the stabilization and growth dimensions. There is a fusion of the structural policies and the supply side policies of changing this sectorial balance in the economy. And it is necessary for these policies to be brought together. Governments are constantly in a state of balancing these different long-term and short-term policies. Well intentioned governments, governments that are serious, need time and supportive environments in order to carry out those reforms, both the traditional price mechanism kind and the more State directed kind. An adverse economic environment or the idea of a short-term shock treatment to the economy are not helpful circumstances.

I think there is a definite tradeoff and very definite problem in the conduct of the international institutions in the divergence between these two approaches rather than collaboration between them.

Mr. BEREUTER. I know my time has expired, but I would like to see if Dr. Phaup has any kind of response he feels he would like to make?

Mr. PHAUP. I appreciate the opportunity to respond. I think where we may disagree is not so much the intention of Government policy or what we know to be the correct thing to do theoretically, but whether or not we can do it.

The vision that I have of the position that was just stated is that as we devalue the exchange rate, as we contract Government expenditures, as we reduce subsidies, we are able to reduce production in one area and switch production smoothly into export oriented industries.

One question is whether or not that can be done quickly or whether or not it takes some time. I am not sure it can be done at all. I am not sure, that is, that the governments, even those which are regarded as market-oriented, highly developed economies like our own, are capable of the kind of coordination that is being proposed.

It seems to me that it is unlikely that we have the kinds of tools to so finely tune the economy as to precisely be able to reduce one type of spending as we replace it with increases say in external demand.

So it is not so much that I would disagree with the notion that it would be desirable to have this kind of meshing, I just don't think it is possible. Given that, a more rapid sort of response it seems to me is more appropriate and I think that is where we may disagree.

Mr. FRIED. Mr. Chairman, if I may.

Chairman LUNDINE. Please do.

Mr. FRIED. I think when one states as a general proposition, that adjustment and growth are consistent objectives, there is little disagreement. The specifics can be another matter; some kinds of adjustment can contribute more to growth than others. For example, this I think is a particularly important part of Bank Fund collaboration at its best. The Fund may be disposed, acting quickly to say we must have a reduction in aggregate demand immediately, and the Government in response, says we do it across the board.

The Bank can come in and say, through its structural adjustment lending, that while such a reduction in aggregate demand is needed, it should be done selectively, not across the board. For ex-

ample, cutting should be heavier, say, in some public sector area that may be inefficient and lighter—or not at all—in areas where there are greater possibilities for expanding exports.

This is exactly what the Bank does try to do in promoting economic policy reforms through structural adjustment lending. Where the Bank and the Fund work closely together in this way, their collaboration has been, and will be, most productive. As far as promoting the restoration of growth is concerned, there can be good adjustment programs and bad adjustment programs. Collaboration can facilitate the former and minimize the latter.

A second point we really haven't as yet raised here is the dimension of time. Obviously, adjustment requirements vary tremendously country by country. In some cases, it is politically possible to move fast; in other cases, it is politically impossible to move fast without getting the kind of political instability and turmoil that none of us wants to see, let alone the country involved. This is an element that has to be taken into account. It is difficult, if not impossible, for the Bank and Fund to do this, but we, as a Nation, have to worry about it.

I think the possibility of getting rapid adjustment, for example, in countries of sub-Sahara Africa at this time are virtually zero. To push it would make no sense. We are not going to get it. What we have to work for is a steady improvement in policies, which everyone recognizes are now very bad but we have to expect such improvements will take more time and to plan on that basis. There is no other way out of it unless we want to see complete turmoil, unrest and indeed, chronic, widespread famine in the continent.

Thank you.

Chairman LUNDINE. I think Mr. Dale wants to comment.

Mr. DALE. In a sense, the problem of coordination between the two organizations is more difficult than Mr. Fried mentioned, because when the Fund often—with serious countries that are doing their best to adjust and to grow—and the Fund and the country agree one of the central elements is to reduce the fiscal deficit, fine; it turns out sometimes, for reasons that have nothing to do with the preferences necessarily of the Fund or the Bank, that politically it may be easier for that country to reduce development spending than almost anything else, just because of the constituency situation in the country. And that is where you really get unfortunate conflicts between stabilization and growth. But again, it is because of the political forces more than anything else I would say.

Also, Ed Fried is right; time is a critical dimension. Now, of course, in some cases—and I am speaking now for the 1982 and some 1983 cases—we just didn't have very much time. But there is another factor as well. Sometimes it isn't recognized as much as it should be that the severity of adjustment programs are the way they are because very often the total amount of external resources available to the country, whether from the Fund, Bank, and bilateral sources, add them all up and that is a given number. And there is a tradeoff between the rapidity and severity of adjustment on the one hand, and the level of growth in inflation on the other, I would suggest to you that we often need to think carefully which is more economically and even politically explosive in a lot of coun-

tries as between severity of adjustment on the one hand and growth of inflation on the other.

Chairman LUNDINE. Mr. Parris.

Mr. PARRIS. Thank you. I have enjoyed very much the comments of these gentlemen this morning. I apologize for being here a few minutes later. I am sorely tempted to dive into the subject of the Pacific rim countries' economic development and so forth. I would suggest, Mr. Bradford, it has something to do with the societal factors working, favorable exchange rates, lower unit costs, et cetera. Those certainly play a part, I am sure you would agree. It is an interesting thing to talk about, but not now.

I wanted to make a couple of comments about a paper that the chairman, Mr. Lundine, put before us this morning, and I think it summarizes what I think this hearing is all about, and it says in part, while a bank's responsibilities are those of a development institution, it is generally acknowledged bank development programs cannot work if an IMF adjustment program has the effect of working at cross purposes. I don't think any of you gentlemen got into that aspect of it. What if the World Bank is trying to do one thing and the IMF, for one reason or another, its activities are at cross purposes with it?

And then a suggestion is made, as the World Bank has substantially more resources at its command, can and must it help fill the medium-term financing gap faced by many of the countries once the IMF program has expired? Are we, in fact, going to simply point, designate or suggest that the World Bank step in and bail out the IMF with the LDC debt problems, and so forth? Can the World Bank insure that these adjustments so painfully achieved under an IMF austerity program be consolidated into sustainable growth? Good question.

The suggestion this morning, I think, by all of you gentlemen at one time or another in your testimony or your comments was that commercial banks will not be a net source of additional capital, and their resource flow will not be from commercial financial institutions, certainly in the United States.

Mr. Chandler preached some questions this morning. Is Latin America, as a Third-World debtor, assuming a disproportionate share of the debt crisis, a situation created in part by commercial banks, I would add, under an earnest request for attractive profit and loss statements and earnings per share by management, et cetera?

I guess this is more a statement than a question. Let me put a question mark at the end of this last sentence—

Chairman LUNDINE. Take your choice.

Mr. PARRIS [continuing]. And ask essentially the question, there are some of us who serve on these subcommittees, and others, who are concerned about the status, if you will, of international finance, and if I may paraphrase this question, if I might. The International Development Association funds are at an alltime low. We all know—you gentlemen have talked about deficits. We wrestle with that problem every day. And it is an extremely difficult one, politically, if for no other reason.

The Bank, World Bank, obviously, left with the option of providing market rate interest rate loans to almost all recipient coun-

tries, cultivating more commercial lending to the LDC's if they can, which I just suggested to you they probably cannot, but if they can, through cofinancing, both options are not without obstacles, as I am sure you would agree. You talked a moment ago about some Latin American countries can simply not afford to pay the interest. We all know that.

The question is, what do we do about that? Commercial bankers are questioning, thank goodness, the wisdom of participating in a cofinancing arrangement with the Bank where their timeframe for turning a profit is less than 3 years—the Bank is usually 10 years or more. How do you relate that reconcilable objective? And have we gone too far in terms of the commercial financial interest in this Nation to be caught working our way out of this, I think, dangerous situation in terms of the international debt crisis?

I just took 4 of my 5 minutes, I am sure, posing the question. Can you all answer it in 30 seconds?

Chairman LUNDINE. I will exercise the prerogative of the Chair and say that the witnesses may respond to any aspect of those questions posed that they want, and we won't restrict your time in so doing.

Mr. Fried.

Mr. FRIED. First, Mr. Parris, are the two institutions essentially working at cross purposes, which was the burden I think of your earlier, initial remarks. This brings us back to the question of whether stabilization and growth are contradictory objectives. I believe that the Bank's view is one that it shares with the Fund, namely that growth cannot take place unless progress is made toward stabilization.

So the first initial task is to achieve stabilization. And that involves some of the questions we have addressed, including how much restraint is needed to achieve balance, through what reforms, over what time period? I think that the Bank's role in this, particularly recently in providing structural adjustment lending, is to work toward having a stabilization program that is most consistent with development. Real questions arise here. But there is no essential contradiction, although some programs are more conducive to growth than others and differences on that score must be resolved so that the efforts of the two institutions reinforce each other.

Second, does the Bank, in providing long-term resources, bail out the Fund? Generally no. Of course, the Bank's projects and its structural adjustment loans are designed to increase the supply of resources in one sense or another, and that in the end is the major contribution to be made in regaining the capacity to repay all loans, including those of the Fund. So growth is necessary, and that is what the Bank is trying to promote.

There is a very serious specific problem, however, which should be brought to the attention of this committee: Namely, the Fund's repayment problems in Africa. I am not completely familiar with the details, but the Fund has virtually exhausted its lending powers in a number of sub-Sahara African countries. As a result of the collapse of commodity prices and the world recession in 1981-82 some of these countries are in literal or virtual default. If the Fund is to be a continuing player in the effort to bring constructive

change to these exceedingly poor countries, the international community in one sense or another is going to have to address this problem, either by changing the rules in the Fund on repayment or by providing additional resources through bilateral aid programs or in some other way. Until this happens the Fund is not going to be able to play its role in some countries, and I think it is essential that it do so.

As a final point, there is the question you raised regarding World Bank co-financing with the commercial banks, namely is there an inconsistency between the World Bank providing long-term loans and the commercial banks being interested only in very short-term loans if they are interested at all. I believe that was the burden of your question, Mr. Parris.

It should be emphasized that one of the important functions of the Bank is to serve as a catalyst for or to promote, the resumption of commercial bank lending to countries which are emerging from their present problems. It has various devices to do this. One is straight co-financing in which the commercial banks take a share in financing Bank-designed projects. That works in some countries.

The Bank also has arrangements in which the commercial banks take the short end of a loan, say the first 10 years, and the Bank takes responsibility for the outer years. This is another means of restoring confidence.

My main point, in answer to your question, Mr. Parris, is that collaboration between the commercial banks and the World Bank is still possible. I think the World Bank is working toward this end. I don't think it is accomplishing as much as it would like. But I think that the restoration of effectively working economies in some countries in the developing world would be facilitated by success in that program.

Thank you.

Chairman LUNDINE. Does anyone else want to comment? Don't feel that you have to, but you are welcome to.

Mr. PARRIS. Thank you, Mr. Chairman.

Chairman LUNDINE. Mr. Fried suggested the possibility of joint negotiations with individual countries between the Fund and the Bank. Other witnesses before our subcommittee previously have suggested that perhaps we ought to try a demonstration effort where the Bank and the Fund, with the request of a country clearly needing both types of assistance, undertake a simultaneously, joint program both to facilitate immediate adjustment and long-term economic growth.

How would that strike all of you as a suggestion? I notice it didn't strike anybody very much.

Mr. BRADFORD. Hasn't it been done?

Mr. DALE. It depends what you mean precisely by simultaneously and joint, Mr. Chairman. Chile would be an example where obviously the two negotiations were done at the same time, concluded at about the same time, and so on. If you mean by simultaneous-joint, something like joint missions with a single group of staff people conducting both negotiations simultaneously, then I would have problems with it. I think you can achieve virtually the same

results by a careful process, and I think that has been achieved in a number of cases.

Chairman LUNDINE. Anybody else have any comment?

I think there is essential agreement among you that the missions of the two institutions should remain with the Fund dealing with short-term adjustments and balance-of-payment problems, and the Bank concentrating on a longer term development strategy or loaning countries longer term development funds.

Is there a gap in between where there is some more medium-term financing needed that goes beyond the current ability of the World Bank through its structural lending program to meet?

Mr. Fried.

Mr. FRIED. Mr. Chairman, that is exactly what the Structural Adjustment Lending Program was. That is a gap that program was designed to meet.

Chairman LUNDINE. Let me follow up. Is the 10 percent requirement or limitation on it realistic in light of the debt crisis that exists?

Mr. FRIED. That it seems to me is a real question. I don't think there is a limitation that exists in any statutes. The Bank has traditionally adopted that in the past as a limitation on what we call program loans. But, in fact, the Bank provides, I think, something like 20 or 25 percent of its total lending goes in the form of loans in which it can exercise some leverage in getting policy reform.

The first is, of course, the structural adjustment loan as such, which I think is 10 percent or so of its total lending. There are the sector loans, a loan, for example, to an agricultural sector in a country rather than a series of projects in that sector, on the basis of clear understandings, delineated understandings of what policies will be pursued over this period in achieving the goals that the Bank and the Government agree are necessary. I believe that—again depending on the progress made in a particular country—that an increase in structural adjustment loans may be very appropriate and the Bank should be in a position to do so.

I think it is very difficult to say that the total amount of lending at any given time should be much larger than it is. I won't say it. But I do say that the Bank should be in a position to move should conditions warrant it. I don't think it is in that position now, warranted in a sense of dealing with a serious debt problem that may emerge.

Mr. DALE. The Bank has one other possibility it used, starting in the fall of 1982, and that is it took a whole series of administrative actions to speed up the disbursement of even a number of project loans in relation to heavily indebted countries. This is a one-time, one-shot effect the Bank can have. But at that time, it played a very important role in some of the heavily indebted countries. I recall in the case of Brazil, for example, it made a very significant difference in the amount of actual disbursements the Bank was able to make during a critical period in the Brazilian situation.

Chairman LUNDINE. I have two more questions. First, Mr. Fried observed that there is a serious contradiction in the amount of lending by commercial banks to developing countries. If anybody disagrees that that is a condition and that it is likely to continue for a

while, I would appreciate your stating that disagreement. I assume otherwise there is general agreement on that point.

If one assumes these same countries are going to continue to have at least the same amount of credit needs they have had in the past, where is that money going to come from?

Mr. FRIED. Well, I think a good program in a given country means that growth will be fostered in part by improved policies domestically, which would both mobilize a larger amount of savings and use them more effectively at home.

I think the real issue, in this case, I think—

Chairman LUNDINE. By addressing capital flight, you are saying that they could reduce their amount of requirements for debt from abroad?

Mr. FRIED. Let me say in the first place that foreign capital, as such, generally plays a fairly small role quantitatively in the total capital invested in any given country. I think the total for the developing world as a whole may be on the order of 15 percent of total invested capital. So the biggest part of capital is mobilized domestically.

But it is also clear that foreign capital frequently plays a crucial role because it represents both foreign exchange, which may be urgently needed at any given time, and constitute a bottleneck. It may also embody in some cases expertise, marketing ability, technology, and other aids to investment.

With more efficient policies in these countries and the restoration of balance, a turnaround will occur, among other things in stopping and eventually reversing capital flight. Capital inflows will be necessary if countries begin moving ahead; otherwise their recoveries could restrain or abort. However, the resumption of capital flow from private banks is going to take some time because it will require a great deal more confidence in the economies of these countries than the banks now have. They clearly are shell shocked and are very concerned, understandably so, about their exposure in these countries. So in the middle-income countries the Bank and the Fund are going to have to play a key role in assuring that the flow of foreign capital is adequate to needs.

The flow of foreign capital to the poorest countries, to Africa in particular, is a completely different proposition. We have to understand that. There foreign capital plays a crucial role and what happens is going to be dependent on what the international community is prepared to do, through IDA and through bilateral aid. But IDA is critical, and we so far have not been able to face up to that problem.

Chairman LUNDINE. I will pose one other question. Are we whistling our way through the graveyard with respect to Latin American debt? I wondered, in my mind, whether it is a fair question to ask at this hearing, which is about joint cooperation. A case could be made, I think, that the Fund comes in and they get Mexico to take abrupt action, and we all take a deep breath and say, "Wow, the crisis is averted," and now things seem to be coming unraveled in Mexico. Now we are celebrating Argentina's new-found discipline and strong leadership.

In the meantime, Brazil doesn't seem to have much leadership. Venezuela doesn't want to play at all, and they barely can make

interest payments, to say nothing of coming to grips with the enormity of their debt problems. How would you react to the question of are we whistling our way through the graveyard? Mr. Bradford.

Mr. BRADFORD. Well, I think there is room for substantial concern in two regards. First is that it seems to me that those projections that give one peace of mind essentially are what I call smooth path projections. You look at Bill Cline's projections on the debt problem or the World Bank's, you tend to get a view things can be worked out over time. They assume away essentially the possibility of sudden shocks. Most particularly, the one thing you are aware of that concerns people is the possibility of a sudden drop in the dollar and a rise in interest rates to respond to that to keep capital flowing into the United States. That is a possibility that has been talked about for a long time, but that is the kind of thing that is not easily taken into account by some projections about the debt problem.

Chairman LUNDINE. If I can interrupt, some projections assume the business cycle is going to go away too, that we are not going to have another recession.

Mr. BRADFORD. That is the second point I was going to make. The thing that has really made a difference, as you know, in the last couple of years has been precisely the imbalance in our own policies which has led to a huge trade deficit, and it is that which has enabled the Latin American countries, in particular, to get through the last 2 years of the debt crisis. What you find now is a tremendous concern as the U.S. economy cools off and slows down about what this means. The Europeans and Japanese don't appear to be in a position to expand, so there is no offset to our own contraction as far as the debt countries are concerned.

And what you find, in World Financial Markets—by Morgan Guaranty Bank in the May issue on Latin American trade policies—you find very real concern for what the impact of this decline in the U.S. market growth rate would have. I think there is major new pressure on the Latin American debtor countries, as the export picture for them has changed so dramatically, over the next few months.

Chairman LUNDINE. Would anyone else like to comment?

Mr. DALE. I agree, there is plenty to worry about. The crisis will be with us through a long twilight struggle. On the other hand, I am not saying anyone here reacts this way, but you often run into the reaction of people throwing up their hands and saying, "My God, it is impossible to deal with these debts," or, on the other hand, turning to arrangements, none of which are practical at all.

I think it does a great disservice to try to get discussion of some of these doctrines that won't work. The only real option we and the countries concerned have is to keep emphasizing that good policy will, with reasonable luck, deal with these problems over a long term. If you suppose we have any other option, I am afraid you are mistaken.

Chairman LUNDINE. I apologize if I raised a Chicken Little sort of question.

Anyone else? Mr. Phaup.

Mr. PHAUP. I would agree with the comments Mr. Dale made, I think clearly what we have to do is continue to urge countries to

adopt the appropriate policies. In the Mexican example, it is not clear to me that the policies that one might recommend for more thorough adjustment were in fact adopted. They still have roaring inflation rates, not due necessarily to a declining peso, but because of overexpansionary credit increases. They still maintain stringent controls on prices. It is not clear to me they have adopted a full set of adjustment programs.

Chairman LUNDINE. It is not even completely clear foreign investment is welcome.

Mr. PHAUP. That is another point I wanted to make. It seems to me, the primary responsibility of development among developing countries rests with developing countries. They, in fact, have to adopt the appropriate policies, and in the absence of the appropriate policies, they are not going to attract capital, they are not going to do any of the things necessary for growth to occur on a sustainable long-term path.

I think the role of the two agencies is to continue the policies, to insist upon those kinds of policies that in the past have been associated with high rates of growth in these economic systems.

Just a final comment, the fact of the matter is that mistakes have been made. Too much may have been loaned or borrowed and some costs may ultimately have to be paid for those mistakes. It seems to me that what we need to do is recognize those costs may need to be paid. What we should do is not figure out a way to pretend they are not there, but find ways to contain them.

I find it heartening that some of the larger banks that are showing larger profits before loan loss provisions are generating more and more funds in those loan loss provisions. That seems to me to be a prudent thing for them to do.

Chairman LUNDINE. Chairman Neal.

Chairman NEAL. All of you, in answer to the last question, have used phrases like "good policy, appropriate policies." It seems quite appropriate, but I just noticed, for instance, Mr. Bradford was somewhat critical in his comments of the IMF-World Bank for adhering to what he called rigid ideological models of good policy and suggests governments ought to have more latitude in determining their own policies.

It raises a couple questions. What is good policy? If the Fund and the Bank think they know what good policy is, should they insist on it? I certainly would agree dogmatism is unwarranted, but the Fund and the Bank have a lot of experience in these fields. We commit U.S. taxpayers' dollars to these funds, other countries do also. It seems to me a little more appropriate if we think the programs are flawed, we ought to withhold more money from the institutions instead of just letting—essentially letting the money go to countries that practice policies that we think are not healthy.

Just as an aside, I personally, if I were on the Fund board, would not lend our country any money until it agreed to shape up either. I wondered if you want to comment on that. You know, these policies—I am thinking especially of Fund policies now—are not always popular, to say the very least. You know, we have certainly explored a whole range of options during hearings on the Fund over the years, and all the Members of Congress have a wide variety of suggestions as to how the Fund ought to operate differently. I

think I came to the conclusion their basic policies make a lot of sense. If we go too far in some other direction, we destroy the usefulness of the Fund.

Mr. Bradford, would you want to comment?

Mr. BRADFORD. Yes. It is a difficult issue to clarify, I mean you fall in the realm of sort of the obvious of saying good policies are policies that are good and bad policies are policies that are bad. In a way I have seen some stuff written that really gets down to that level of generalization.

I think that very few policymakers or economists would disagree with the idea that the exchange rate is an instrumental variable in any short-term or long-term program and that it needs to be adjusted in a way that is consistent with the internal inflation rate of the country and to keep the real exchange rate so that it does not discriminate in a massive way against exports or induce more imports than an effective exchange rate would. It is very difficult to disagree with the idea that fiscal deficits should be brought under control, that monetary constraint is a necessary thing, that enhancing market prices is a good idea.

But what is, I think, difficult to do is to say that that leads then to the adoption of a simple solution, a sort of single model of what stabilization means, which can be summarized as getting prices right. I think what unfortunately is the case recently is that this idea of getting prices right, which means more than just adopting policies that I have just suggested, but also means opening the economy to world market prices by eliminating import controls in one fell swoop, taking subsidies off in one fell swoop, pulling the Government back from any allocation role or guidance and role in terms of sectoral development, is gaining ground as a model for policy.

I think that is not realistic in terms of what can reasonably be asked of countries nor is it realistic in terms of the suddenness with which it impacts on a country in terms of the surge of import requirements that would come about, the sudden shifting from one set of sectors to another.

What is really required is a more gradual, medium-term approach that is not so single minded in its one dimensionality—either one dimensionality in terms of getting prices right or in terms of thinking about constraining demand without any real attention to the output structure and supply side.

I would like to go back, if I may, for just a second to Chairman Lundine's point about us being totally comfortable with the separateness of the roles of the two institutions that we are talking about today. Because, as I said in my opening remarks, I think the Fund is too short term in its orientation. The three instruments I mentioned are available for medium-term adjustment of these various variables, which would then mesh in a 3- to 5-year period with the longer financing of the Bank.

But it is true that the guidelines for conditionality established in March 1979, prior to this period of more restrictive shorter-term policies of the Fund, do allow for this sort of medium-term outlook in terms of the policy outlook of the conditionality. So that the instruments for a 3- to 5-year time horizon and the policy outlook in

this March 1979, set of guidelines promulgated by the directors of the Fund are both in place.

And the point I am making is that they aren't being utilized and that this does create, I think, more of a divergence between the Bank and the Fund and make it more difficult for countries to make this adjustment, both in terms of the market allocations, and government adjustments, than is really necessary. I hope that clarifies the problem rather than obscures it.

Chairman NEAL. Just one brief comment. I am not sure it is necessary to make this comment, but it is not my experience that the Fund is as rigid as your comments might have suggested.

Mr. BRADFORD. It is worth inquiry. I don't think any witness who comes before you can pretend to have the whole truth. But it is an issue, I think, that is worth looking into.

Mr. DALE. I am glad you made that comment. It probably comes better from you than me. I agree with what you just said. I just want to go back briefly to one of the earlier points you made, which is the obvious truth that the Fund is not always very popular. That is true, but I have found over the years that where the Fund gets blamed for things—first of all, that may be helpful in the Fund being able to take some of the heat, as it were, off of a government that is taking measures.

Also, I have found many cases where if a government really explains fully and candidly and with a professional, political flare, what it is doing and why it is doing it, it is quite remarkable what they can do without seeming to provoke very much in the way of political protest, whereas in many of the cases that one hears about where Fund programs become extremely controversial it is really because the explanation was totally inadequate and sometimes didn't exist at all and on occasion was perverse in the sense they explained they were going to do one thing and then did another.

I don't think it is absolutely necessary for these programs always to be controversial. I take the view that good economics is good politics, and I think there are plenty of examples that would show that.

Mr. FRIED. Just one brief note. I think that it is evident that humility is always required in this, as far as policy advice to other countries are concerned, judging at least from our perspective in our own country and what has happened generally in the world. So I think that goes pretty much without saying.

That having been said, I would agree, and I think all of us would, with the series of measures, evidences of good policy that Colin Bradford raised, that is obviously the correct thing to do. I go back to the fact that what is at issue here in part is a political problem. How fast can you do this? These are unpopular. Can you say to a country, "Look, here is what you have to do; otherwise you will have to jump over the cliff." The fact is that it is not to the country's advantage or our advantage for this to happen.

So, the whole negotiation of how to achieve stabilization and growth is, in part, I repeat, a political process. One of the functions of the Fund and the Bank is to be able to facilitate this process and get the optimum policy mix, and that mix usually is in terms of how much time can be permitted for change to take place. This has some bearing on Chairman Lundine's question about Chicken

Little and whether the debt problem is much more serious than we care to admit. Yes, the problem will be with us for some time. It will require continued and steady attention. The most important instruments we have available from the outside are the Bank and the Fund and these two institutions will continue to have to collaborate closely in the future. And one of the responsibilities that you gentlemen have, as well as the country as a whole has, is to see that the Bank and the Fund will continue to have the resources and the instruments to do the job.

Chairman NEAL. I just wanted to comment, in response to what Mr. Dale said, that I can give you a lot of examples of very bad economic policy being very popular also.

Mr. DALE. True.

Chairman LUNDINE. Mr. Bereuter?

Mr. BEREUTER. I have no further questions.

Chairman LUNDINE. I want to thank all of you. It isn't really that we don't have any other questions, but I think that the testimony and responses to our previous questions has been really very helpful to this joint subcommittee. We are not just doing this as a learning process, although that is certainly in this member's view one of my objectives, but also to try to see if we can make a contribution to U.S. policy and attitudes toward the Bank and Fund and toward our role as a leading economic initiator in its entirety.

You have contributed, all of you have contributed significantly to our understanding of the situation and perhaps some ideas regarding how we might approach it and what kind of recommendations we might make.

Thank you again for your testimony.

[Whereupon, at 11:40 a.m., the joint subcommittees were adjourned.]

